SUPREME COURT, U. S.
FILED
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No. 75-248

IN THE

# SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1975

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**HERBERT F. KORHOLZ,**
*Petitioner,*

v.

**MARY M. DASHO, Executor of the Estate of WILLIAM A. DASHO, Deceased, DASHO-ROGERS, INC., an Illinois corporation, and MAURICE H. SCHY**

and

**THE SUSQUEHANNA CORPORATION, a Delaware corporation, et al.,**
*Respondents.*

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## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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Respondents.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Petitioner, HERBERT F. KORHOLZ, prays that a Writ of Certiorari issue to review the Order and Judgment of the United States Court of Appeals for the Seventh Circuit entered on May 27, 1975, which affirmed approval of a partial settlement of this case.

## OPINIONS OF THE COURTS BELOW

On September 23, 1974, the district court, pursuant to Fed.R.Civ.P. 23.1, issued a judgment and memorandum opinion approving in all respects a settlement agreement entered into by nine of the twelve individual defendants (the "Settling Defendants"), The Susquehanna Corporation ("Susquehanna") and plaintiffs in this derivative stockholders' suit. The court, pursuant to Fed. R.Civ.P. 54(b), entered final judgment in favor of the Settling Defendants. A copy of the judgment and the unreported opinion is set forth at

Appendix A.

Petitioner appealed provisions of the settlement agreement which required Petitioner's former lawyers, who are also attorneys for the Settling Defendants, to cooperate with plaintiffs and Susquehanna in the further prosecution of this action against Petitioner and the other two individual defendants not parties to the settlement agreement (the "Remaining Defendants"). On May 27, 1975, the court of appeals issued an order affirming the judgment of the district court. A copy of that unreported order is set forth at Appendix B.

Other opinions in this case, which are not related to the judgment sought to be reviewed, are:

(1) Opinion and Order dated April 15, 1966, and Opinion on motion for rehearing

dated June 28, 1966, dismissing Count I and transferring Count II of the complaint. 267 F.Supp. 508 (N.D. Ill. 1966).

(2) Opinion of the United States Court of Appeals dated June 26, 1967, reversing the district court's dismissal of Count I. 380 F.2d 262 (7th Cir. 1967).

(3) Opinion and Order dated February 19, 1968, denying Defendants' motion to dismiss Count II of the complaint. (Unreported).

(4) Opinion and Order dated October 21, 1968, granting Plaintiffs' motions to strike portions of answers of certain Defendants to Amended Count I of the complaint. (Unreported).

(5) Opinion and Order dated February 28, 1969, granting Defendants' motion to strike Plaintiffs' jury demand, and denying Defendants' motion that Plaintiff Schy may not maintain derivative action. (Unreported).

(6) Opinion and Findings of Fact and Conclusions of Law, dated February 6, 1970, dismissing action as to all Defendants. CCH Fed.Sec.L.Rep. '69-'70 Transfer Binder, ¶92,575 (N.D. Ill. 1970).

(7) Opinion of the United States Court of Appeals, dated January 18, 1972, reversing the dismissal of the action as to twelve individual defendants. (Appendix C). 461 F.2d 11 (7th Cir. 1972).

## JURISDICTION

The order of the Court of Appeals for the Seventh Circuit was entered on May 27, 1975. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

## QUESTIONS PRESENTED

The primary issue presented is whether the district court, in fulfilling its obligations under Fed.R.Civ.P. 23.1 to rule on the fairness of the settlement in a derivative stockholders' suit, may approve a partial settlement agreement which requires attorneys who represented a Remaining Defendant in earlier stages of the same action or who received confidential communications from that defendant in the course of joint trial preparation to aid plaintiffs in further prosecution of the case against their former client. Several questions relating to the terms of the settlement agreement

(which is set forth in the Appendix at D) are subsidiary to the central issue:

1. Whether the district court must forbid attorneys who represented a defendant in earlier stages of a case before it from entering into an agreement to "consult" with plaintiffs in the same matter in the course of trial preparation against that defendant.

2. Whether the attorney cooperation provisions of the settlement agreement create a risk of disclosure, inadvertantly or otherwise, of confidential information reposed by Petitioner in his former lawyers.

3. Whether the attorney cooperation provisions of the settlement agreement impermissibly require Petitioner's former lawyers to serve conflicting interests, in violation of the ethical obligations of the legal profession as expressed by Canon 4 of the Code of Professional Responsibility of the American Bar Association.

4. Whether the attorney cooperation provisions of the settlement agreement on their face create the appearance of impropriety, in violation of the ethical obligations of the legal profession expressed by Canon 9 of the Code of Professional Responsibility.

## STATUTORY AND REGULATORY PROVISIONS INVOLVED

Code of Professional Responsibility, American Bar Association, Canons 4 and 9 (Appendix at E and F).

Federal Rule of Civil Procedure 23.1 (Appendix at G).

## STATEMENT OF THE CASE

### I. Earlier Proceedings

This case was brought as a derivative action purportedly on behalf of Susquehanna shareholders against all of the then directors and several of the former directors and officers of Susquehanna.

The case was tried to the Honorable Abraham L. Marovitz between September 17 and October 22, 1969. On February 6, 1970, Judge Marovitz entered judgment in favor of all defendants and dismissed the complaint. On January 18, 1972, the court of appeals reversed the determination of the trial court that plaintiffs were not entitled to a jury trial and remanded this matter for retrial against twelve individual defendants on two legal issues, but affirmed the findings in favor of all defendants on all equitable issues.

II. Lawyers Who Represented Petitioner During The First Trial Agreed In A Partial Compromise Of This Action To Aid Plaintiffs And Susquehanna In Further Prosecution Of This Case Against Their Former Client

On October 3, 1973, Susquehanna, plaintiffs and nine of the individual defendants presented a "Stipulation of Compromise and Settlement" to the district court. In March and April, 1974, the

court conducted a hearing pursuant to Fed.R.Civ.P. 23.1 on the fairness of the settlement. Petitioner objected to the provisions of the Stipulation (paragraph 5) which required attorneys for the Settling Defendants, including Petitioner's former lawyers in this case, to cooperate with plaintiffs and Susquehanna in further prosecution of this case against Petitioner and the other Remaining Defendants by:

1. Consulting with plaintiffs and Susquehanna in connection with trial preparations (paragraph 5(b));

2. Speaking freely and without reservation in the course of such consultations about relevant matters (paragraph 5(c)); and

3. Producing for plaintiffs and Susquehanna all relevant documents and other tangible material including attorneys' work products (paragraph 5(d)).

Paragraph 5 of the Stipulation is found at pages D10-D14 of the Appendix.

On September 23, 1974, the district court entered a memorandum opinion and order approving the partial settlement, including the challenged attorney cooperation provisions. The court directed, pursuant to Fed.R.Civ.P. 54(b), that final judgment be entered as to the Settling Defendants.

Petitioner appealed approval of the attorney cooperation provisions to the United States Court of Appeals for the Seventh Circuit on the ground that these provisions required attorneys to serve conflicting interests in the same litigation, inherently risked disclosure of Petitioner's confidences, violated the ethical norms of the legal profession and would prejudice Petitioner on retrial of this case. On May 27, 1975, the court of appeals, in an unpublished order, affirmed the district court's approval of the attorney cooperation provisions. The court ruled that paragraph 5(g) of the Stipulation (Appendix D12 and D13), by which

parties to the agreement purported to define the manner and extent to which the lawyers involved would be required to serve conflicting interests, adequately protected Petitioner's interests.

III. The Lawyers Subject To The Attorney Co-operation Provisions Had An Attorney-Client Relationship With Petitioner In This Case.

Petitioner was represented during the first trial and subsequent appeal of this case by the firm of Rhyne & Rhyne, which also represented five of the Settling Defendants and Susquehanna. A partner in that firm was lead defense counsel during the first trial. The firm also represented Petitioner in a companion case, Berman v. Thomson, 65 C 2051, in the Northern District of Illinois, and in several other matters. Following the court of appeals' remand in 1972, the firm was discharged by Susquehanna and withdrew as counsel for Petitioner, but continued to cooperate with Petitioner and his present counsel in preparation for retrial.

The firm of Schiff, Hardin & Waite represents the other four Settling Defendants. Starting prior to the first trial and continuing until the partial settlement, counsel representing all defendants participated in joint defense effort. This co-operation continued after Petitioner's present counsel entered the case. In addition, a partner and an associate from Schiff, Hardin & Waite participated in an all-day conference with Petitioner, during which they received confidential communications from him and reviewed his personal files.

In the course of this cooperation, attorneys from Rhyne & Rhyne and Schiff, Hardin & Waite and Petitioner's present counsel jointly interviewed potential witnesses; jointly prepared for depositions of expert witnesses; consulted with potential expert witnesses for the defense; held numerous conferences on tactics, strategy and

possible settlement; produced numerous documents (some of which may not constitute attorney work product); and jointly engaged in other activities.

The firms of Rhyne & Rhyne and Schiff, Hardin & Waite had no connection whatsoever with Susquehanna, Petitioner or the Settling Defendants at the time of the transactions which are the basis of this derivative action. They received all information and knowledge which would be the subject of the "consultations" under paragraph 5(b) and received or produced all documents and other tangible materials subject to the production under paragraph 5(d) solely in their capacity as defense counsel in this case.

## REASONS FOR GRANTING THE WRIT

The attorney cooperation provisions of the partial settlement require attorneys for the Settling Defendants to violate the ethical

standards of the legal profession expressed in Canons 4 and 9, Code of Professional Responsibility of the American Bar Association by serving conflicting interests in the same litigation and by placing themselves in a position where they might, consciously or unconsciously, reveal confidences reposed in them by a former client; and creates the impression of impropriety. If lawyers had privately agreed to undertake the duties specified in the attorney cooperation provisions, the district court should have disqualified them. However, the conflict of interest and possibility of disclosure of confidences in this case did not arise from a private, ex-judice retainer, but is required by the provisions of a compromise agreement in a derivative action, an agreement that was ineffective without the approval of the district court. Fed.R.Civ.P. 23.1. The attorneys are required by

court order to engage in a course of conduct which is forbidden by the ethical norms of the legal profession.

The district court's approval and the court of appeals' affirmance of the attorney cooperation provisions departs sharply from the general rule that ethical standards of the legal profession are to be strictly construed. If this decision stood by itself, the Court should grant a writ of certiorari in exercise of its general supervisory power over the administration of the federal judicial system, Mesarosh v. United States, 352 U.S. 1 (1956), Thiel v. Southern Pac. Co., 328 U.S. 217 (1946); to correct this aberration. However, the decision of the Seventh Circuit does not stand in a vacuum, but conflicts with the recent decision of the Second Circuit in Hull v. Celanese Corp., 513 F.2d 568 (2d Cir. 1975). The decision at

issue also conflicts with the standards of the Third and Ninth Circuits, a district court decision in the Fifth Circuit and the applicable law of Illinois, the forum state.

In Hull v. Celanese Corp. a firm and an individual lawyer were disqualified under circumstances strikingly similar to this case. Hull brought an action against her employer, Celanese, alleging sex-based employment discrimination in violation of Title VII of the Civil Rights Act of 1964, 42 U.S.C. §2000e. A Celanese staff attorney worked on the matter for a six-month period which ended shortly after the action was filed. She subsequently consulted Hull and her lawyers and, represented by Hull's attorneys, moved to intervene as a plaintiff. The district court denied her motion, 375 F.Supp. 922 (S.D.N.Y. 1974), because of her prior professional involvement in the defense of the case.

The court gave full credit to her statement that she had not revealed anything learned in confidence to Hull or their joint attorneys. The court stated, however, that the opportunity for inadvertent disclosure was "clearly ever present" and declined to permit Celanese "to suffer the possibility of unintended disclosure by [the attorney] to other plaintiffs or their joint counsel of matters learned by her in confidence while working on this case as a Celanese attorney." 375 F.Supp. at 924. The court also noted that the requirement that a lawyer avoid even the appearance of impropriety (Canon 9) was sufficient to require denial of the motion to intervene, but stated that under the facts it need not decide on appearances alone. The court's reasoning would require disqualification of the firm of Rhyne & Rhyne, which represented Petitioner in this case for 5 years.

Subsequently, the district court granted Celanese's motion to disqualify Hull's attorneys because their consultations with the Celanese staff lawyer provided ongoing possibilities for improper disclosure, creating at least the appearance of impropriety (73 Civ. 3725 (S.D.N.Y. July 12, 1974)). The United States Court of Appeals for the Second Circuit affirmed, 513 F.2d 568 (2d Cir. 1975).

Both the district court and the Court of Appeals recognized the presence of three interests: (1) plaintiff's interest in freely selecting counsel of her choice; (2) defendant's interest in a trial free from risk of even inadvertant disclosure of confidential information; and (3) the public's interest in the scrupulous administration of justice. The first consideration is completely absent here, since Petitioner is not seeking to disqualify the lawyers actually representing

plaintiffs. The Second Circuit stated that any doubt is to be resolved in favor of disqualification, and held that the admonition of Canon 9 made disqualification necessary to enforce the lawyer's duty of absolute fidelity and to guard against the danger of inadvertant use of confidential information.

Hull's attorneys argued that since they never represented defendant, they never had direct access to defendant's confidences, and since they had cautioned the Celanese attorney not to reveal any information received in confidence from defendant, they had avoided indirect access to confidential information. This is extremely similar to Respondents' argument in both the district court and the court of appeals that the settlement agreement avoids the possibility that confidences will be revealed because paragraph 5(g) of the

settlement agreement forbids the attorneys for the Settling Defendants to reveal confidences. The Hull court rejected this argument, which it termed "somewhat technical in nature" as overlooking the spirit of Canon 9, which requires disqualification whenever it can reasonably be said that the lawyer might have acquired information in the course of his prior representation related to the subject matter of the present representation - a breach of confidence would not have to be proved, it is presumed in order to preserve the spirit of the Code.

Hull's attorneys, like Schiff, Hardin & Waite, never actually represented or filed an appearance for the party seeking disqualification. Schiff, Hardin & Waite lawyers, however, unlike Hull's attorneys, actually did receive confidential information from Petitioner. Schiff, Hardin & Waite is not only in a position where they might have

received confidential information, they did in fact receive confidential information. Consequently, Schiff, Hardin & Waite should have been disqualified from complying with the attorney cooperation provisions of the settlement agreement.

In his oral argument before the court of appeals*, Mitchell Rieger, a lawyer for the Settling Defendants, recognized the importance of the Hull case, which he termed "the straw that broke the camel's back as far as all of us collectively coming to grips with our responsibility," and represented to the court that, in light of

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*The Court of Appeals entered an Order on May 27, 1975 authorizing the Clerk to permit any party to copy the transcript of the oral argument in this case (Appendix at B-4). Quotations from Mr. Rieger's argument are based upon a transcription of the tape of his argument prepared by employees of Petitioner's present counsel.

Hull, appellees had not agreed to enforce paragraph 5(b) of the settlement agreement. He stated that Hull held that "the appearance of impropriety is a problem so that even if you say you're going to do the right thing and the lawyers are committing themselves and representing to the Court -- that's not enough." Respondants' apparent claim before the court of appeals that their private agreement to limit the scope of the attorney cooperation provisions complied with Hull is therefore obviously incorrect. In any event, the court of appeals affirmed the provisions which Respondents conceded were improper, and stated that it had not relied upon Respondents' representations in so affirming.

Other circuits have adopted standards similar to those adopted by the Second Circuit in the Hull case. In Richardson v. Hamilton International

Corp., 469 F.2d 1382 (3d Cir. 1972), the Third Circuit disqualified a derivative plaintiff because he had performed services as a lawyer for several of the defendants a number of years prior to the transactions giving rise to his suit. The court did not doubt plaintiff's good faith, but stated that he should not be permitted to place himself in a position where, even unconsciously, he might be tempted, or it might appear to the public and to his former clients that he might be tempted, to take advantage of information derived from confidences placed in him as an attorney.

The Ninth Circuit in Chugach Electric Association v. United States District Court for the District of Alaska, 370 F.2d 441 (9th Cir. 1966), also disqualified an attorney who had represented the adverse party prior to the transactions

upon which the suit were based because of the possibility that confidential information obtained from the client during the prior representation would provide him with greater insight and understanding of the subsequent events relevant to the suit.

The court of appeals' decision here also conflicts with the district court's decision in E. F. Hutton & Co., Inc. v. Brown, 305 F.Supp. 371 (S.D. Tex. 1969), in which the court set forth two criteria for disqualification:

1. When the former client provided confidential information, the lawyer is disqualified if continuing his employment might cause him to reveal or absue the confidences of a former client.

2. Whether or not the former client provided confidential information, the attorney will be disqualified for representing conflicting interests

if the subject matter of the later representation is substantially related to the subject matter of the former adverse representation. 305 F.Supp. at 392-400. Disqualification of lawyers for the Settling Defendants is required under both criteria.

State law on the issues presented is admittedly not controlling. However, the decision of the court of appeals is in conflict with the long-established standards of Illinois, the forum state. In People v. Gerold, 265 Ill. 448, 107 N.E. 165 (1914), the Illinois Supreme Court held that disqualification was required when an attorney places himself in the position in which he might reveal confidences reposed in him by a former client. If the former client has not reposed confidential information in him, the lawyer is forbidden to accept conflicting employment in the same general matter against his former client. 107 N.E. at

175-78. The Gerold standards have been followed in later Illinois cases. C.f., In re Michal, 415 Ill. 150, 112 N.E.2d 603 (1953); In re Williams, 57 Ill.2d 63, 309 N.E.2d 579 (1974).

The settlement agreement in this case requires attorneys who represented Petitioner or who received confidential information from him to provide professional services to adverse parties in the same matter. The Seventh Circuit's approval of this arrangement conflicts with the controlling decisions from three other circuits and the law of the forum state. This Court should grant a writ of certiorari to review this anomaly.

## CONCLUSION

For the reasons stated, Petitioner prays that a writ of certiorari issue to review the order of the United States Court of Appeals for the Seventh

Circuit entered on May 27, 1975.

Respectfully submitted,

/s/ Holland C. Capper

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FInancial 6-6191

August 18, 1975.

APPENDIX A.

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

| | | |
|---|---|---|
| MARY M. DASHO, Executor of the Estate of WILLIAM A. DASHO, Deceased, DASHO-ROGERS, INC., an Illinois corporation, and MAURICE H. SCHY, Plaintiffs, | ) | |
| v. | ) | No. 65 C 1757 |
| THE SUSQUEHANNA CORPORATION, a Delaware corporation, et al., Defendants. | ) | |

MEMORANDUM OF DECISION

PHILIP W. TONE, Circuit Judge, Sitting by Designation.

Before the court in this shareholders' derivative action is a proposed settlement between plaintiffs and certain defendants. Nine of the twelve individual defendants, corporate defendant Susquehanna Corporation, and plaintiffs are parties to the agreement. The proposed settlement is opposed by the three remaining individual defendants,

only one of whom, Herbert Korholz, was still a Susquehanna shareholder at the time of the hearing, and two other Susquehanna shareholders, Jeri Berman and Minnie Wisotsky, who are plaintiffs in another shareholders (sic) derivative suit, Berman v. Thomson, 65 C 2051 in this court, involving the same proxy statement challenged in Count II of the complaint in this case. 1/*

The long history of this case and its facts appear from the two opinions of the Court of Appeals in Dasho v. Susquehanna Corp., 380 F.2d 262 (7th Cir. 1967), cert. denied, 389 U.S. 977 (Dasho I) and Dasho v. Susquehanna Corp., 461 F.2d 11, 14-20 (7th Cir. 1972) (Dasho II). In Dasho II the Court of Appeals reviewed a judgment in favor of defendants entered by Judge Abraham L. Marovitz in February, 1970 after a bench trial, reversed and remanded for a jury trial as to legal issue in

1/* For all footnotes, please refer to the Footnote Index at the end of this Memorandum of Decision.

light of Ross v. Bernhard, 396 U.S. 531 (1970) and affirmed as to the equitable issues. After remand, the case was assigned by the Executive Committee of this court to District Judge Bernard M. Decker, after which it was transferred to me as a District Judge of this court on October 31, 1972. Following a series of pretrial conferences and the preparation by counsel of a stipulation of facts, proposed jury instructions and special verdicts, and after some delay because of the health of one of the defendants, the case was set for trial October 18, 1973.

Two weeks before the trial date, counsel for plaintiffs, counsel for defendant Ralph A. L. Bogan, Jr. and eight other individual defendants ("Settling Defendants")[2/] and counsel for defendant Susquehanna Corporation advised the court that they had entered into an agreement to settle the case as to those nine defendants. Notwithstanding the

lateness of the presentation of this agreement, I felt that the court could hardly require parties who desired to settle the issues between them to continue litigating, unless the settlement could not be approved. Since proceeding to trial with the remaining defendants prior to the hearing on approval of the settlement agreement, would have necessitated two trials if it developed that the settlement could not be approved by the court, the trial was continued. The proposed settlement agreement is now before the court for judgment on its fairness and equity.

Counsel for plaintiffs and counsel for defendant Herbert F. Korholz and the other two remaining individual defendants ("Remaining Defendants")[3/] continued to negotiate and reached an agreement during the latter part of October, 1973. Susquehanna, however, opposed the settlement. The court never reached the issue of whether the

corporation's consent was necessary for judicial approval of the agreement, because the Remaining Defendants were unwilling to go forward with the settlement unless they were assured that Susquehanna Corporation would be required to indemnify them for attorneys (sic) fees and expenses incurred in the litigation, which, of course, Susquehanna refused to do voluntarily. I ruled on January 17, 1974, that I could not determine at that time whether the Remaining Defendants were entitled to indemnity for attorneys (sic) fees and expenses, because, under the Delaware Corporation Law, disposition of the indemnification cross-claims should await final determination of the Remaining Defendants' liability.[4/] The proposed settlement with the Remaining Defendants, because it did not resolve the important issue of attorneys' fees and litigation expenses, could not be submitted to shareholders or considered for approval by the

Court.

By order of January 17, 1974, a hearing on the proposed Bogan group settlement was set for March 22, 1974, and a court-approved notice was sent by Susquehanna Corporation to all of its shareholders of record as of the close of business on December 31, 1973. The notice described the history and post-remand status of the Dasho litigation, the terms of the settlement agreement under consideration, the posture of the related case Berman, et al. v. Thomson, et al., 65 C 2051 (N.D. Ill.), the plans for a hearing on the fairness of the settlement, and the availability of relevant papers in Dasho and Berman. An abbreviated form of this notice was published in the national edition of the Wall Street Journal on one day during each of the two weeks following the week in which the notice was mailed to shareholders. Opportunity was given for the submission of memoranda commenting on the

proposed settlement, and three days of testimony and argument were received by the court on March 22, April 1, and April 2, 1974. Subsequently, memoranda and supporting exhibits were filed with the court by counsel for all parties who had participated in the hearing. Briefing was completed in July, 1974.

Position of Defendant Susquehanna Corporation.

Since the decision of the Court of Appeals in Dasho II, Korholz has lost his role and any influence he may have had in Susquehanna's management, and he and the corporation are adversaries. Susquehanna is represented by new counsel, who actively participated in the settlement negotiations and insisted upon certain terms being included in it which imposed obligations on the Settling Defendants and were themselves the subject of extensive negotiations.

As stated above, Korholz and two other

Remaining Defendants reached an agreement with respect to settlement with plaintiffs, but Susquehanna's new management and new counsel refused to agree and opposed this settlement before this court. I refused to submit that proposed settlement to shareholders, as stated above, in view of its failure to dispose of the important subject of attorneys (sic) fees.

The Berman Case.

The Berman action, referred to above, is pending before Judge Richard B. Austin. Plaintiffs in that action, objectors here, challenge the same proxy statement that is challenged in Count II of the amended complaint at bar on a ground different from those asserted at bar. In Berman it was contended that the proxy statement was materially false and misleading because it failed to identify the investment of "approximately 6 million dollars in marketable securities of listed domestic

corporations" referred to in a balance sheet footnote as being entirely in stock of General Refractories Corporation. Judge Austin sustained this contention in granting summary judgment of liability on behalf of the Berman plaintiffs and against defendants Korholz, Susquehanna and American Gypsum in May, 1970. Berman v. Thomson, 312 F.Supp. 1031 (N.D. Ill. 1970). The Berman case was filed on behalf of Jeri Berman in 1965, after the initial complaint in the case at bar, which asserted what is now Count I, and before the amendment of the complaint to add Count II, which challenges the proxy statement. Minnie Wisotsky became an additional plaintiff in Berman by intervening in 1971. Four of the nine Settling Defendants here are named as defendants in Berman. It is undisputed that all of the grounds on which the proxy statement is challenged in this case could have been asserted in Berman, and, conversely, the ground asserted in

Berman could have been asserted here. Plaintiffs in both cases assert derivatively the rights of Susquehanna. Although the Berman complaint contains class action allegations, it appears that there has never been a determination under Rule 23 that the action may proceed as a class action, and there has never been any notice to the purported class. There appears to have been no proceeding in Berman to determine damages after the entry of summary judgment of liability in 1970. Meanwhile, the Court of Appeals has reviewed the judgment entered by Judge Marovitz in this case in 1970, and has definitively determined Susquehanna's derivative rights to damages arising from the proxy statement challenged here and in Berman.

Summary of the Proposed Settlement Agreement.

The settlement agreement under consideration provides essentially as follows:

1. The nine Settling Defendants[5/] will pay

collectively to Susquehanna the sum of four hundred and five thousand dollars ($405,000). (Sec. 3, p. 6).

2. The Settling Defendants will release Susquehanna from any claims that they might have against the company for payment of any judgment or settlement amount, attorneys' fees, or other expenses of litigation incurred directly or indirectly in connection with this action (Dasho v. Susquehanna, 65 C 1757), or Berman, et al. v. Thomson, et al, 65 C 2051 ("Berman"), or any related proceeding. (Sec. 3, p. 6; Exhibit B.)

3. The Settling Defendants will assign to Susquehanna any claim they might have, including claims for contribution or indemnity, against any person (including a Remaining Defendant 6/) arising out of the claims which were asserted or could have been asserted against them in the present case or in Berman. (Sec. 3, p. 6; Exhibit C.)

4. Plaintiffs and Susquehanna will covenant not to sue or continue suit against the Settling Defendants, including suit to recover Susquehanna's payment of their past attorneys' fees and expenses. (Sec. 4, p. 6; Exhibit D.)

5. Susquehanna will defend, indemnify, and hold harmless the Settling Defendants against any action brought by any one or more of the Remaining Defendants., M. J.

Coen, State Mutual Life Assurance Company of America, and Massachusetts Mutual Life Insurance Company for contribution in connection with the present action or in Berman. (Sec. 4, p. 6; Exhibit E.)

6. The Settling Defendants and their counsel will cooperate with plaintiffs and Susquehanna in the continued prosecution of this action and of Berman or any related proceedings, against the Remaining Defendants, and M. J. Coen, State Mutual Life Assurance Company of America, and Massachusetts Mutual Life Insurance Company. In the event of default each of the Settling Defendants agrees to pay Susquehanna $45,000 in liquidated damages. (Sec. 5, pp. 7-9.)

7. Susquehanna and the Settling Defendants will bear all filing fees, costs, and disbursements necessary for the implementation of the Settlement Agreement in accordance with the following formula: Susquehanna and the Settling Defendants will each be responsible for one-half of the foregoing up to a total of $15,000; Susquehanna will then be responsible for the foregoing up to a total of $19,000; and then Susquehanna and the Settling Defendants will each be responsible for one-half of the foregoing for the excess over $19,000, except that Susquehanna and the Settling Defendants will each be responsible for its or his own legal fees and expenses. (Sec. 12, pp. 11-12.)

8. If the Settlement Agreement is approved

by the court, the parties to the settlement will submit to the court an order providing for final judgment in favor of the Settling Defendants and dismissing the amended complaint on the merits with prejudice. A copy of this proposed order is attached to the Settlement Agreement as Exhibit A. (Sec. 7, p. 10; Exhibit A.)

9. The requested order would contain provisions permanently barring and enjoining the institution or prosecution by any person (including Susquehanna and any of its shareholders proceeding on behalf of Susquehanna) of any claim against the Settling Defendants which has been or might have been asserted derivatively on behalf of Susquehanna relating to the matters alleged in the present action, and any action for contribution against the Settling Defendants by the Remaining Defendants. These provisions are made severable by another provision of the proposed order. (Exhibit A to Settlement Agreement, pars. 4, 5 and 9.)

The Court's Function.

Rule 23.1 Fed.R.Civ.P. provides that derivative actions by shareholders "shall not be dismissed or compromised without the approval of the court...." As recently stated by one court in approving the settlement of a derivative action,

> "The Court's function on this motion is not to try out or attempt to decide the merits of the action. Rather, the Court's responsibility is to reach 'an intelligent and objective opinion of the probabilities of ultimate success should the claim be litigated' and to 'form an educated estimate of the complexity, expense and likely duration of such litigation ...and all other factors relevant to a full and fair assessment of the wisdom of the proposed compromise.'" Lewis v. Newman, 59 F.R.D. 525, 527 (S.D.N.Y. 1973) (footnotes omitted).

Evaluation of Litigation

We are not without guidance in assessing the likelihood of plaintiffs (sic) ultimate success against the Settling Defendants and the amounts likely to be recovered in the event of success. We are assisted by the decision of the Court of Appeals in Dasho II (461 F.2d 11) and must, of course, defer to that Court with respect to matters dealt with in its opinion. We are also aided by the evaluation of the facts reflected in the findings of the District Court in the prior bench trial.

In Dasho II the Court of Appeals did not merely reverse for a jury trial in light of Ross v.

Bernhard, 396 U.S. 531 (1970). It affirmed the findings of the District Court on all equitable issues in the case and defined the issues to be tried to the jury upon remand and the proper measure of damages under each count. It is reasonable to assume that the record on retrial would be substantially the same as those portions of record relating to the issues to be retried which were reviewed by the Court of Appeals in Dasho II. That Court's evaluation of the evidence is, therefore, very helpful in our consideration of the proposed settlement agreement.

Damages Under Count I

The Court of Appeals appears to have considered that the maximum amount recoverable as damage to Susquehanna in connection with the VCA stock transaction, which is the subject of Count I, is $682,500.00. (461 F.2d at 18, 25, including n. 33, and 27.) If, as plaintiffs contended at the

first trial and before the Court of Appeals (461 F.2d at 24-25), material facts were misrepresented or withheld from some members of the Board of Directors, those members would not be liable. Alternatively, if the entire Board was interested in the transaction, as alleged in the complaint in allegations sustained in Dasho I (380 F.2d 262, 269-270), all would be liable. The Court of Appeals expressed doubt in Dasho II about whether the second theory had "enough evidentiary support to justify submission to a jury" but pointed to evidence that would support a finding that Korholz had deceived other members of the Board. 461 F.2d at 26. If liability under Count I is based on the first theory, which was obviously regarded by the Court of Appeals as the most likely to succeed and which was the one relied on by plaintiffs at the first trial and in the Court of Appeals, the Settling Defendants will not be liable under that count.

Damages Under Count II

Any damages recoverable under Count II are to be based, under the opinion of the Court of Appeals, upon a revision of the exchange ratio:

> "In other words, if the exchange ratio was unfair to Susquehanna, it was injured by the merger.
>
> ....
>
> "If the jury could properly find that Susquehanna's approval of the terms of the merger was obtained by fraud, and that a full disclosure of all material facts would have required an adjustment of those terms in order to obtain the necessary authorization to consummate the transaction, the conclusion that the corporation was in fact damaged by the fraud would be supportable. Assuming the existence of a violation and consequent injury, the question would then be whether the record contains any evidentiary basis for a reasonable calculation of the amount of that pecuniary injury." (461 F.2d at 27, 28.)

The Court also said,

> "...a damage award must, in effect depend on a revision of the exchange ratio." (461 F.2d at 30.)

Applying the 2.02 to 1 ratio which the Court of

Appeals stated as the top figure in "a tolerable range of fairness" (461 F.2d at 28) would produce damages of $814,065.25.[7/] While the Court would not have intended to place a fixed ceiling on the damages recoverable under Count II, its carefully reasoned treatment of the theory and measure of damages affords an indication of the range of damages it thought reasonably supportable. The Court also noted, "A jury cannot be permitted to make a random selection of any exchange ratio that might appeal to it." 461 F.2d at 28. Of course, the damages might be much less than the amount stated above.

A finding of liability under Count I would presumably also affect liability and the amount thereof under Count II. The value of Susquehanna pre-merger assets would be increased by $682,000, which would appear to produce an inequity in the exchange ratio in an amount in excess of $300,000. This liability is presumably allocable to those

responsible for the Vanadium transaction. It is not clear whether this item was taken into consideration in the Court of Appeals' discussion of damages. (461 F.2d at 28.)

Probability of Ultimate Success Should the Claims Be Litigated

There is little that I can add, on the subject of probability of the plaintiffs' ultimate success, to the appraisal of the case by the Court of Appeals in Dasho II. As to Count I, the Court was not sure there was sufficient evidence to go to the jury on the alternative theory of liability that would permit recovery against the Settling Defendants. I must conclude that the chances of recovery against them under Count I would not be great.

Under Count II recovery depends upon whether plaintiffs can prove "value misrepresentations," under defendants' view, or upon whether plaintiffs can prove any material misrepresentations, in

plaintiffs' view. Plaintiffs' theory is that if they can show any misrepresentations that would have caused the Susquehanna stockholders to vote against the merger, then they can recover the difference between the amount a "fair" exchange ratio would have produced and the amount the actual exchange ratio produced. Defendants argue that since only the propriety of the exchange ratio is in issue, the Court of Appeals having held that the merger should not be set aside and that any damages under Count II resulted from too low an exchange ratio, the misrepresentations or omissions upon which plaintiffs can rely must relate to the values which determine the exchange ratio. The Court of Appeals (sic) opinion does not resolve this issue. When it was presented to me in the course of preparation for the second trial, I withheld ruling until after trial and the return of special verdicts which are to be submitted to the jury. I am inclined to

believe that plaintiffs' view of the matter is correct, but it is by no means clear that the Court of Appeals would agree. The possibility that judges will differ on this issue is what led me to order special verdicts so the case will not have to be tried again however this issue is ultimately resolved.

The jury must determine whether "a more favorable exchange ratio would have been available if there had been a full disclosure," which

> "requires an evaluation of the transaction from Gypsum's point of view as well as Susquehanna's. For if it were plain from the record that Gypsum's shareholders would not in any event have approved a merger on terms which required surrender of more than 1.9 of their shares for each Susquehanna share, then approval of those terms, even if unlawfully obtained did not harm Susquehanna," (461 F.2d at 31.)

Assuming that material deceit occurred, the jury might well conclude Susquehanna suffered no pecuniary injury.

It is to be remembered that one reasonable

and knowledgeable trier of fact, Judge Marovitz, who tried the case without a jury the first time it was tried, found that the exchange ratio was fair. This finding was set aside because Ross v. Bernhard, 396 U.S. 531 (1970) required a jury trial of the issue, but the Court of Appeals expressly stated that the finding was not clearly erroneous. It is not unlikely that the six other reasonable men comprising the jury on retrial would reach the same result Judge Marovitz reached, which would mean that there would be no recovery under Count II against any defendants.

Complexity and Difficulty.

An assessment of the complexity and difficulty of this litigation can be made by the reader from the opinion of the Court of Appeals in Dasho II. I can add nothing except to say that the necessity of trying the case to a jury materially increases the difficulty of preparation for trial

and trial. This has already been demonstrated by the efforts to date made under the direction of the court to prepare satisfactory jury instructions and forms of special verdict, efforts which have not only been marked by sharp disagreements among the parties but which presage the difficulty of making the facts and the issues comprehensible to laymen. As counsel for objector Wisotsky observes in his Reply Memorandum (p. 24),

> "Any lawyer experienced in financial matters knows that it is almost impossible to present effectively, to a jury, a complicated fact situation such as that in Dasho...." 8/

Future Expense.

No meaningful estimate can be made of the future expense to the corporation which would result from continued prosecution of the case against the Settling Defendants. The corporation has already advanced over $800,000 to or for the benefit of the individual defendants in this case and in

the Berman case. Much of this is not recoverable against the Settling Defendants or the other defendants whatever the outcome of a jury trial in this case, because a large portion is undoubtedly allocable to the equitable issues which were decided favorably to the individual defendants by the Court of Appeals' affirmance of the District Court's findings on these issues in Dasho II. The corporation will presumably be liable under its indemnification obligation for all fees for all defendants in this case if plaintiffs do not prevail on the retrial.

Ruling on Settlement.

I approve the proposed settlement with the following modifications:

(1) Paragraph 4 of the proposed order, purporting to enjoin and bar all persons from asserting claims against the Settling Defendants, will not be included in the order. It will be for the judge before whom any other case may be pending to determine the effect of the judgment in

this case that will be entered pursuant to the settlement agreement.

(2) The court has no power to bar any indemnification or contribution claims which remaining defendants Korholz, Thomson and Martin may assert against the Settling Defendants without a trial or hearing on those claims, and paragraph 5 of the proposed order approving the settlement will not be included in the order to be entered.

The settlement provides that both paragraphs 4 and 5 are "severable," which I understand means that the settlement is to survive in the event of their deletion.

The settlement would produce for the corporation $405,000 in cash, and a waiver by the Settling Defendants of their claims for indemnification for attorneys (sic) fees and expenses incurred in this case and the Berman case since 1971. The cash amount is reasonable in relation to the amounts likely to be recovered against the Settling Defendants. The exposure of the corporation to claims for past and future indemnification for

attorneys (sic) fees and expenses is substantial, and counsel for the corporation as well as plaintiffs would seem to have good grounds for their belief that the fee compromise is reasonable and advantageous to the corporation.

Given the amounts involved when the plaintiffs' claims are assessed in the light of the Court of Appeals' opinion in Dasho II, and the substantial risk that Susquehanna will ultimately either recover nothing from any defendant or recover nothing from the Settling Defendants and thus incur substantial additional liability to indemnify the Settling Defendants for their litigation expense, the proposed settlement is in my opinion reasonable and fair. In reaching this conclusion I have given attention to the various considerations advanced by the objectors, including (1) the possible effect of the settlement on the Berman case; (2) the possibility that the Settling Defendants

will be liable for contribution if judgments are obtained in this case or the Berman case against any of the non-settling defendants; and (3) other matters discussed below.

Effect on Berman Case

In Berman v. Thomson, as stated above, other Susquehanna stockholders, suing derivatively on behalf of Susquehanna, challenge the same proxy statement that is challenged here on the ground of a misrepresentation not asserted here, viz., failure to identify a $6 million investment in "marketable securities of listed domestic corporations" as being all in General Refractories stock.[9/] (Although the complaint in Berman contains class allegations, no class determination appears to have been requested in the nine years the case has been pending.) Four of the nine Settling Defendants here are among the eight individual defendants in Berman. Judge Austin's summary judgment of

liability was entered against only Korholz, Susquehanna and Gypsum. The same grounds urged here in challenging the proxy statement could have been asserted in Berman and vice versa.

The pendency of one stockholder's derivative action asserting a claim on behalf of the corporation does not necessarily preclude the bringing of another. It is obviously highly desirable to consolidate such multiple actions at an early stage to avoid the kinds of problems that are now before us. But when that is not done, there must come a time when one case or the other must take precedence and become the vehicle for adjudicating the single claim of the corporation which is asserted in both actions, in this instance the claim that a misleading proxy statement caused a merger on terms less favorable to Susquehanna than might have been obtained. When one of the cases is tried and reviewed by the Court of Appeals of the Circuit in which

both cases are pending, the decision of the Court of Appeals must be treated as the law of the case as to both cases. The alternative would be that the Court of Appeals, as well as the District Court, would be free to decide the same claim of the same corporation in two different ways. Only one judgment for damages caused Susquehanna by a misleading proxy statement can be entered against the same defendant. The basis for such damages and how they are to be measured has been defined by the Court of Appeals in Dasho II. The existence of Berman at most provides another possible ground of liability, on the basis of which there may be a revision of the exchange ratio in accordance with the law of the case declared by the Court of Appeals in Dasho II.

The summary judgment of liability in Berman against Korholz, Susquehanna and Gypsum was entered by Judge Austin May 14, 1970. There appear

to have been no proceedings initiated by plaintiffs in that case since that date to obtain a judgment for damages. In any event, this case was tried to judgment after that date and reached the Court of Appeals in a posture which enabled that Court to lay down the rules governing the assertion of the claim that is presented in both cases. The Berman plaintiffs did not seek to intervene in this case at any stage. Because this case, involving as it does the claim that the same proxy statement was misleading, reached the Court of Appeals first, the law applicable to both cases was established by the Court of Appeals (sic) opinion in this case.

The Court of Appeals having established the law applicable to the claim of Susquehanna asserted derivatively in this case and in Berman, and by its mandate having ordered this Court to retry the case in accordance with its opinion, this Court is required to obey that mandate and thus

required to proceed to final judgment through trial or settlement. Just as the existence of the Berman case cannot be an obstacle to trying the case at bar and entering a final judgment on the jury's verdict, the existence of that case cannot prevent this Court from entering a judgment based on a settlement.

The foregoing is not intended to suggest to Judge Austin, before whom Berman is pending, the effect, if any, that judgment in this case will have in Berman, for I would not presume to do that. My purpose is only to explain why I believe Berman can have no effect on whether the settlement before me is fair and equitable.

In summary, Berman, in my view, represents an adjudication, binding on the parties to the interlocutory judgment in that case, that at least in one respect the proxy statement challenged here was misleading. Under Dasho II, a finding that the

proxy statement was misleading cannot result in setting aside the merger but only in an award of damages. Whether there is liability for damages may depend on whether the Berman misrepresentation was a value representation; but assuming that it was or that it need not be, there still remain the issues of whether Susquehanna suffered any damages by reason of the merger and if so how much. In finding the settlement reasonable I have assumed that the proxy statement will be found materially misleading in one or more respects. The doubtful questions of fact of damage and amount of damages still remain and are to be determined under the principles stated in Dasho II. Accordingly, my opinion on the reasonableness of the settlement assumes the theoretical liability found to exist in the summary judgment of liability in Berman.

Indemnity Against Contribution Claim.

Turning to the matter of indemnity, it is

obvious to begin with, that no defendant in such a case as this would be willing to enter into a settlement agreement that did not contain a provision for indemnification against contribution claims.[10/] Absent such a provision, a defendant's settlement payment would be an installment payment on his ultimate liability in the event of a judgment favorable to plaintiffs; and if the ultimate judgment turned out to be against the plaintiffs, the payment would be one he would not have had to make. If a settlement was to be made with fewer than all defendants, it had to include indemnification terms as a practical matter.

As stated above, if recovery is had under Count I, it would appear unlikely that it would be on the theory that all directors were culpable. The Court of Appeals expressed doubt about whether there was enough evidence to go to the jury on this theory. Recovery under Count I would probably be

based on the theory pursued by plaintiffs at the first trial and on appeal and found to be tenable by the Court of Appeals, that material facts were misrepresented to or withheld from the Settling Defendants. If that is the theory of liability, the Settling Defendants would not be liable for contribution as to Count I. Accordingly, very little of the settlement amount should be allocated to Count I, under which, as observed above, the maximum recovery by plaintiff appears to be $682,500.

The exposure of the Settling Defendants would appear to lie under Count II, where the probable maximum recovery, upon a realistic view of the case in light of Dasho II, would seem to be something less than $1,000,000. I shall not explore here the law of contribution under the federal securities acts. I called some of the cases to counsel's attention during hearings in open court, and there are extensive discussions of this branch of the law in

the briefs. Relative degree of fault may well be a relevant consideration affecting contribution rights. See ALI, Federal Securities Code, Tentative Draft No. 2, §1418(f) (1973). It is sufficient for present purposes to assume that there is a substantial risk that if the non-settling defendants are held liable under Count II in this case or in Berman they will be entitled to assert claims for contribution against the Settling Defendants. 11/

We have observed that the Court of Appeals has said that any damages recoverable are those resulting from any unfairness in the exchange ratio. If the exchange ratio was unfair, Susquehanna issued more shares to Gypsum stockholders than it would have if the ratio was fair. The beneficiaries of this were the Gypsum stockholders. At the time of the merger Korholz and his wife and daughters owned 56.8 percent of Gypsum's stock and, of this, Korholz individually owned 29.4 percent. Accordingly

Korholz and his family received the economic benefit of about[12/] 56.8 percent of the overissue, and Korholz himself received the benefit of almost 29.4 percent.

A claim for contribution is equitable in nature. Brown v. Goldsmith, 437 P.2d 247, 248 (Okla. 1968); Rell v. Combes, 159 N.E. 133, 134 (Ohio Ct. App. 1927); Maresh v. Jennings, 38 S.W.2d 406, 408 (Tex. Civ. App. 1931). Before recovering contribution pro rata from other joint tortfeasors, Korholz would surely be charged with the amount by which he was enriched by the conduct he participated in. He should also be charged with the amount by which his wife and daughters were enriched. The amounts left for pro rata contribution would thus be much smaller than the amount of the judgment.

To the extent that an adjustment of the exchange ratio under Count II contains an increment attributable to the Vanadium transaction challenged

in Count I, the liability would seem to be that of the defendants who are liable under Count I, who would probably not include the Settling Defendants. Thus the amount of such an increment could not be the basis for contribution claims against the Settling Defendants.

The indemnity for contribution risks which Susquehanna provides under the agreement does not, under all the circumstances, render the settlement agreement unfair to Susquehanna, in my opinion.

Other Arguments.

In considering the argument of the Berman plaintiffs that plaintiffs here do not adequately represent the other shareholders, and that Schy should be disqualified, I must view the case as if those objections had been advanced as an obstacle to plaintiffs' further prosecution of the case in a retrial. Would I be justified in disobeying the Court of Appeals' mandate to retry the case on the

ground that I have now concluded after all these years that the plaintiffs do not adequately represent the other shareholders? Much has been said and written about Schy's agreement with respect to an attorney's fee, recent disclosures concerning the terms of that agreement, and Judge Marovitz' finding that he adequately represents the class. The same problems would exist if the case were about to be tried, yet I would be obliged to follow the Court of Appeals' mandate, try the case, and deal with the matter of attorneys' fees later. Whether Schy receives any attorney's fee is subject to the control of the court.

In any event, there has been no showing that plaintiff Dasho does not adequately represent the other shareholders. Objector Wisotsky says Mrs. Dasho is unsophisticated. The record does not show whether Mrs. Dasho is less sophisticated than Ms. Wisotsky, who professes to adequately represent

other shareholders. They are both adequate representatives of shareholders if they are free of conflicts of interest and are represented by competent counsel, which they are.

Plaintiffs' counsel are experienced and highly competent trial counsel well qualified to handle this difficult case and adequately advise Mrs. Dasho. They have prosecuted this case aggressively through one trial and two appeals, and have won the right to a jury trial on damages. There is no basis for questioning the integrity and sincerity of their recommendation or their competence to give it.

In addition, the corporation itself, with new management and new counsel, has aligned itself on the side of the plaintiffs in this controversy with the individual defendants, both in this case and in Berman. The corporation has opposed a proposed settlement with the remaining defendants, while approving the one under consideration. Management

and counsel appear to the court to be acting in accordance with their view of the best interests of the corporation. Clearly they have no interest in or concern for the welfare of the individual defendants, either settling or non-settling. In appropriate circumstances, a derivative action settlement sponsored by independent corporate management has been approved over the objections of the plaintiff stockholders. Denicke v. Anglo California National Bank, 45 F.Supp. 524 (N.D. Cal. 1942), affirmed, 141 F.2d 285 (9th Cir. 1944). Here, at the very least, the active role played by independent corporate management helped assure that the corporation's interests, derivatively represented by plaintiffs, were served by the settlement.

I am satisfied that the proposed settlement here is not collusive but was bargained at arm's length by adversaries, and that in the light of all the circumstances it is within the zone of fairness.

The argument that the settlement agreement is invalidated because those who negotiated it refused to give any information about the negotiations to counsel for objector Wisotsky until the negotiations were completed rests upon the dissenting opinion in Masterson v. Pergament, 203 F.2d 315, 324 (6th Cir. 1953). I cannot find in these circumstances a basis for holding that the terms of the settlement are not fair and equitable.

It is also argued that the notice of the proposed settlement mailed to shareholders was inadequate for various reasons. I believe the notice was adequate. Moreover, all conceivable objections to the proposed settlement were aggressively presented by the objectors, and the interests of all shareholders, whatever the viewpoints, were adequately represented.

Defendant Korholz' objections to the cooperation provisions of the agreement are without merit.

The parties to the agreement cannot by their agreement adversely affect the rights of a non-party and they do not purport to do so. Privileged communications are expressly protected by subparagraph (g) of the agreement. I cannot assume that the Settling Defendants or their counsel will invade Korholz' attorney-client privilege.

Appealability.

In view of the length and probable expense of retrial, it would be desirable, in my view, to have the validity of the settlement finally determined before the case is retried against the remaining defendants. The settling parties have indicated that their view is the same by including an appropriate finding in the proposed order approving the settlement. I assume the objectors also want the judgment to be immediately appealable. Accordingly, the order approving the settlement and entering final judgment dismissing the action

as to the Settling Defendants will include a finding under Rule 54(b), Fed.R.Civ.P.

/s/ Philip W. Tone
Circuit Judge,
Sitting by Designation

Dated: September 23, 1974

FOOTNOTE INDEX

Memorandum Of Decision
Appendix A

Page A2:

1/ Initially an appearance and objections were filed on behalf of both Jeri Berman and Minnie Wisotsky the two plaintiffs in the Berman case. Subsequent objections and memoranda have been (filed) on behalf of Minnie Wisotsky only, but I have assumed that Jeri Berman would adopt the same objections and arguments. These objectors will be referred to herein as "the Berman plaintiffs."

Page A3:

2/ Ralph A. L. Bogan, Jr., Edward O. Boshell, M. M. Hardin, J. Earle May, Aksel Neilsen, D. W. Reeves, R. C. Schenk, Harold C. Stuart, and Francis C. Woolard.

Page A4:

3/ Herbert F. Korholz, A. D. Martin , and Albert W. Thomson.

4/ 8 Del. Code §145 (Supp. 1968); Galdi v. Berg, 359 F.Supp. 698, 702 (D. Del. 1973), and Murphy v. Washington American League Baseball Club, Inc., 324 F.2d 394, 398 (D. C. Cir. 1963).

Page A10:

5/ The nine "Bogan group" defendants with whom the shareholder plaintiffs and Susquehanna Corporation have agreed to settle.

Page A11:

6/ Herbert F. Korholz, A. D. Martin, and Albert W. Thomson.

Page A18:

7/ If a 2.01 to 1 ratio had been used, Susquehanna would have issued 75,727 fewer shares to Gypsum stockholders. ([2,421,996 Gypsum shares ÷ 1.9 = 1,274,735] - [2,421,996 ÷ 2.02 = 1,998,008] = 75,727.) At $10.75 per share, this comes to $814,065.25.

Page A23:

8/ The balance of the sentence is, "... even without the mind-boggling effects of inconsistent testimony of turncoats." Counsel was referring to his prediction that testimony given by the

Settling Defendants under the cooperation paragraph of the settlement agreement would be inconsistent with their earlier testimony.

Page A27:

9/ For a complete statement, see Berman v. Thomson, 312 F.Supp. 1031 (N.D. Ill. 1970).

Page A33:

10/ As stated earlier, the court has no authority and no basis at this stage to adjudicate possible indemnification claims among the defendants. Therefore, the provision purporting to bar such claims in the draft order approving the settlement cannot be included in the order the court enters.

Page A35:

11/ In that event, the defendants against whom judgments are entered will have received a credit against the total amount of the judgments for the amount paid under this settlement (less any amounts allocable to attorneys (sic) fees advanced to or on behalf of the Settling Defendants), and each settli.g defendant will be entitled to a credit in the corporation computation for the amount he has paid to the corporation in settlement (less amounts allocable to attorneys (sic) fees).

Page A36:

12/ Korholz owned only 1/2 percent of Susquehanna's stock. Accordingly the economic benefit from an overissue of Susquehanna stock was slightly diluted by his ownership of stock in Susquehanna.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
Chicago, Illinois 60604
Argued May 23, 1975
May 27, 1975

| | |
|---|---|
| No. 74-2050 | ) Appeal from the |
| | ) United States Dis- |
| MARY M. DASHO, et al., | ) trict Court for the |
| Plaintiffs-Appellees, | ) Northern District |
| v. | ) of Illinois, East- |
| THE SUSQUEHANNA CORPORATION, | ) ern Division |
| A Delaware corporation, et al., | ) |
| Defendants-Appellees, | ) No. 65 C 1757 |
| | ) |
| and | ) Philip W. Tone, |
| | ) Judge |
| HERBERT F. KORHOLZ, | ) |
| Defendant-Appellant. | ) |

Before Hon. Luther M. Swygert, Circuit Judge, Hon. John Paul Stevens, Circuit Judge and Hon. William G. East, Senior District Judge*

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ORDER

The court is of the opinion that the provisions of subparagraph (g) of paragraph 5 of the

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* The Honorable William G. East, Senior District Judge of the District of Oregon, is sitting by designation.

Stipulation of Compromise and Settlement, which was approved by the district court, adequately protect the appellant against prejudice which may arise by reason of the performance of the obligations of the settling defendants and their counsel, and that to the extent that ambiguity exists and a construction of the terms of the agreement may be necessary in the light of the professional obligations of the attorneys involved, such matters can best be resolved by the district court pursuant to an appropriate application by any affected party. We are not persuaded that the agreement is invalid on its face or that it raises questions of sufficient importance to justify invalidation of a settlement, which is otherwise invulnerable, of a major aspect of this protracted litigation. In forming this opinion the court has not relied on the representations made by counsel for the various appellees in open court, but will, of course, retain the

transcript of the oral argument for possible use by the district court in connection with its interpretation or administration of the provisions in question.

With respect to appellant's challenge to the district court's failure to hold a hearing on the question of reimbursement or indemnity for litigation fees and expenses, the court is of the opinion that such matters are not properly before it on this appeal.

Finding no basis to reverse the order of the district court insofar as it approves the settlement challenged on this appeal, said order is hereby affirmed.

B4

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
Chicago, Illinois 60604

May 27, 1975

| | |
|---|---|
| No. 74-2050 | ) Appeal from the |
| | ) United States Dis- |
| MARY M. DASHO, et al., | ) trict Court for |
| Plaintiffs-Appellees, | ) the Northern |
| v. | ) District of Illinois, |
| THE SUSQUEHANNA CORPORATION, | ) Eastern Division |
| A Delaware corporation, et al., | ) |
| Defendants-Appellees, | ) No. 65 C 1757 |
| | ) |
| and | ) Philip W. Tone, |
| | ) Judge |
| HERBERT F. KORHOLZ, | ) |
| Defendant-Appellant. | ) |

Before Hon. John Paul Stevens, Circuit Judge.

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ORDER

The Clerk is hereby directed to retain the transcript of the oral argument held in this cause on May 23, 1975, until further order of court, provided, however, that without further order of court,

the Clerk is hereby authorized to permit any party or counsel for any party to make a copy of the whole or any part of said transcript.

APPENDIX C

UNITED STATES COURT OF APPEALS
SEVENTH CIRCUIT

| | | |
|---|---|---|
| WILLIAM DASHO, et al., Plaintiffs-Appellants, v. THE SUSQUEHANNA CORPORATION, et al., Defendants-Appellees. | ) | No. 18572 |

January 18, 1972

Rehearing Denied February 25, 1972

Appeal from the United States District Court
for the Northern District of Illinois
Eastern Division

Before, FAIRCHILD, CUMMINGS and STEVENS, Circuit Judges.

STEVENS, Circuit Judge. American Gypsum Company was merged into Susquehanna Corporation on December 13, 1965. Plaintiffs, as shareholders of Susquehanna, commenced this action in advance of the merger for the purpose of preventing its consummation and also to recover damages for Susquehanna and its pre-merger shareholders. The district court refused

to enjoin the merger and dismissed Count I of the complaint which asserted claims under §17(a) of the Securities Act of 1933[1/*] and §10(b) of the Securities Exchange Act of 1934.[2/] Proceedings under Count II, which asserted that the pre-merger proxy solicitation violated §14(a) of the 1934 Act,[3/] were apparently stayed pending the appeal to this court from the dismissal of Count I.

Count I alleged that Susquehanna had been harmed not only by the merger, but also by an earlier purchase of 222,107 of its own shares at an excessive price. We held that the allegations of fraud or deception in connection with each of these securities transactions were sufficient to state a federal claim under §17(a) and §10(b). Dasho v. Susquehanna Corporation, 380F.2d 262 (7th Cir. 1967), cert. denied, Bard v. Dasho, 389 U.S. 977, 88 S.Ct. 480, 19 L.Ed.2d 470.

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1/* For all footnotes, please refer to the Footnote Index at the end of this Opinion.

Following the remand, there were protracted proceedings in the district court. Count II of the complaint was reinstated, defendants answered, portions of their answers were stricken, extensive discovery was conducted, plaintiffs' request for a jury trial was denied, they amended their complaint, plaintiffs voluntarily dismissed three defendants, the court held a lengthy trial, and thereafter plaintiffs filed still another amended complaint to conform their final theories of the case to the proof. In that pleading they abandoned all charges of conspiracy.

The district court entered extensive findings of fact, conclusions of law, and judgment for the defendants on all claims. On this appeal plaintiffs contend that it was error to strike their jury demand, that the district court misconceived their theory of the case, that critical findings are clearly erroneous, and that vital evidence was

improperly excluded. The threshold question is whether Ross v. Bernhard, 396 U.S. 531, 90 S.Ct. 733, 24 L.Ed.2d 729, which was decided by the Supreme Court after the trial was concluded, requires us to hold that it was error to deny plaintiffs a jury trial. Since we have concluded that it does, we must also identify the issues which should be submitted to a jury for determination when the case is remanded for a new trial.

Before discussing the legal issues, we shall identify the defendants and describe the three securities transactions which gave rise to plaintiffs' derivative action.

I

Susquehanna is a large publicly owned corporation. In April and May of 1965 its shares were traded over the counter in the range between a low bid of 11-1/2 and a high asked price of 14-1/8. At the time of its annual meeting on April 19, 1965,

approximately 2,760,000 shares were outstanding, owned by some 8,750 stockholders. At that meeting, 15 directors were elected, 13 proposed by management and 2 by a group in Kansas City who had cumulated their votes to oppose the management slate. The 13 management directors, led by J. Patrick Lannan, the chairman of the board, owned or controlled about 436,000 shares; however, substantial additional amounts of Susquehanna stock were owned by friends or associates of the 13 management directors and by the Kansas City group represented by the two dissidents.

Prior to May 25, 1965, neither American Gypsum Company, over half of whose shares were controlled by defendant Herbert F. Korholz, nor Korholz himself, owned any Susquehanna stock. After consummation of the three transactions which plaintiffs challenge, Korholz had become Susquehanna's principal shareholder, and the management directors,

as well as the Kansas City group, had sold a major portion of their holdings.

On May 25, 1965, Korholz purchased 430,000 shares from Lannan, certain management directors, and their friends and relatives at a price of $15 per share. On August 11, 1965, in a transaction negotiated by Korholz, Susquehanna purchased 222,107 of its own shares from the Kansas City group at a price of either $13.85 or $10.78 per share, depending on whether plaintiffs' or defendants' version of the transaction is accepted. On December 13, 1965, to consummate the merger with Gypsum, Susquehanna issued 1,274,734 shares to the former shareholders of Gypsum including Korholz, in an exchange which was based on a determination that Susquehanna's stock had a fair value of $10.75 per share. One of the Assets acquired by Susquehanna via the merger was the block of 430,000 of its own shares which Korholz had purchased from Lannan and thereafter

conveyed to Gypsum; one of the liabilities was the bank indebtedness of $6,450,000 which Gypsum had incurred to finance the 430,000 share purchase.

The defendants may be identified in four groups: The Lannan defendants who sold out and resigned from the board in May or shortly thereafter;[4/] the eight members of Lannan's board who remained as directors and shareholders after he sold out;[5/] the two dissidents representing the Kansas City group;[6/] and Korholz and his associates.[7/] Since plaintiffs' conspiracy charge has been abandoned, the different defendants obviously do not share equal responsibility for each of the three transactions which took place on May 25, August 11, and December 13, 1965. Although these transactions were not unrelated, we shall describe them separately.

1. The purchase of 430,000 shares by Korholz on May 25, 1965, was the consequence of discussions between Korholz and representatives of Lannan

earlier that month. The price of $15 per share was about $3.00 over the market when it was agreed upon, subject to certain conditions. Korholz's offer was conditioned upon the resignation of five members of the Susquehanna board, including Lannan, the election of Korholz as chairman of the board of directors and as a member of the Executive Committee, and the election of two Korholz nominees (Nielsen and Hardin) to the Susquehanna board.

The offer was communicated to all 13 management directors, but not to the two dissidents or to the public. The five directors who were to resign sold their Susquehanna stock; the remaining directors made significant contributions to the 430,000 share package, either from their own holdings or from stock owned by friends and relatives,[8/] but each retained an investment in Susquehanna.[9/] Before they voted to elect Korholz, Nielsen and Hardin to the Susquehanna board, the remaining

directors had been advised about the business experience and integrity of the new directors and presumably also knew that the sale of the 430,000 shares at the $15 price was contingent upon their election.

The district court found, however, that the old directors were not aware of the fact that Korholz was making the purchase on behalf of Gypsum rather than as an individual investment. He made the offer and closed the transaction in his individual capacity because Gypsum was disabled from obtaining the necessary financing without the consent of two insurance companies to which it owed several million dollars. Korholz had received informal assurance that such consents would be forthcoming and, therefore, had been able to borrow $6,450,000 from the First National Bank of Boston on the understanding that Gypsum would assume that indebtedness and acquire the 430,000 shares of Susquehanna as soon as conditions specified by the insurance companies had

been met. Those conditions included the election of Korholz as chairman and two of his designees as members of Susquehanna's board of directors, and an assurance from Gypsum that if it were merged into Susquehanna, the merged company would promptly repay the bank loan of $6,450,000.

It is apparent that Korholz, Gypsum, and The First National Bank of Boston were conscious of the fact that Susquehanna's current assets exceeded its total liabilities by over $13,000,000 when the funds to finance the 430,000 share purchase were advanced. The management directors of Susquehanna apparently knew little more than that Korholz, a capable and imaginative executive, was prepared to pay a premium price of $15 per share for about 15% of Susquehanna's stock and to accept a position of major responsibility in the directon of the corporation's affairs.

Precisely what public announcement of the

transaction was made is not clear from the record. The district court found that "when the information as to facts was publicly released promptly after the May 18 board meeting, there was no effect whatsoever on the price of Susquehanna in the over-the-counter market."

The first transaction resulted in a significant change in the ownership of Susquehanna's stock and in the composition of its management, but it had no direct impact on the corporation's assets, liabilities, or capital structure. The balance sheet of Gypsum, however, was materially affected as soon as the arrangements to finance the purchase price had been concluded. It acquired a $6,450,000 asset, consisting of the block of 430,000 shares of Susquehanna, and a new liability of an equivalent amount, represented by the bank loan. Gypsum retained this asset and this liability until it was merged into Susquehanna in December.

2. In the second transaction which was closed on August 11, 1965, Susquehanna acquired 222,107 of its own shares and $300,685 in cash in exchange for 140,000 shares of the stock of Vanadium Corporation of America which Susquehanna had owned for four or five years. The transaction was closed through an escrow at The First National Bank of Boston in which three parties, Susquehanna, M. Coen, representing the Kansas City group, and Vanadium, all made deposits and withdrawals.

Vanadium deposited $3,377,500 in cash and withdrew 140,000 of its own shares;[10/] Coen, on behalf of the Kansas City group, deposited 222,107 shares of Susquehanna stock and made a net cash withdrawal of $3,076,815; Susquehanna deposited the 140,000 shares of Vanadium and withdrew the 222,107 shares of Susquehanna deposited by the Kansas City group and the cash balance of $300,685.

Three versions of this transaction have been

put forward by the parties, one by the plaintiffs and two by the defendants.

Plaintiffs contend that Vanadium's payment of $3,377,500 established the value of the block of 140,000 of its shares, and that a simple calculation of the Susquehanna and Coen deposits and withdrawals reveals a purchase by Susquehanna of a block of its own shares for a price of $13.85, or a premium of about $3 over the market.[11/]

Defendants contend that Susquehanna simply exchanged its block of Vanadium stock for 222,107 Susquehanna shares owned by the Kansas City group, and that the resale of the Vanadium stock for cash was a separate transaction to which Susquehanna was not a party. On the day before the exchange agreement was executed, the mean price for Susquehanna in the over-the-counter market was almost $11, and Vanadium closed at $19.25; the exchange agreement was predicated on a trade of 140,000 shares of

Vanadium at $19.25 each (a total package of $2,695,000) for 250,000 shares of Susquehanna at $10.78 each, with a pro rata cash adjustment to be made if a lesser quantity of Susquehanna shares should be delivered.[12/] Thus, under defendants' first version of the transaction, it was simply an exchange of shares on a market-to-market basis, without any premium attached to either block. In essence, this is the version of the transaction which was reported to Susquehanna's shareholders in the pre-merger proxy statement. Consistently with this interpretation, no disclosure was made of the resale of the Vanadium shares at a price of $24.125, which netted the Kansas City group a premium of $682,500. Defendants contended that such a premium could not have been realized in any sale by Susquehanna because an outstanding injunction prohibited Susquehanna from voting those shares.[13/]

Plaintiffs offered evidence to prove that

defendants knew, or should have known, that a premium was obtainable for the block of 140,000 shares of Vanadium, and that the premium value had been deliberately made available to the Kansas City group to forestall threatened litigation and possible opposition to a merger with Gypsum.[14/]

Defendant's second version of the transaction was that the directors, acting in good faith and exercising an informed, independent business judgment, might deliberately make a premium available to the Kansas City group in order to eliminate the divisive influence on the board represented by the two dissident directors, thereby permitting Susquehanna to function more effectively and harmoniously. The two dissidents remained on the board and thereafter voted consistently with their colleagues. In substance, defendants' second interpretation of the August transaction is that if Susquehanna did, indeed, pay a premium price for the 222,107

shares purchased from the Kansas City group, a corporate benefit of equivalent value was recieved, or at least the directors in good faith so believe. Under this version it is not entirely clear to us whether defendants are contending that the "informed business judgment" of the directors included knowledge that a premium was being made available to the Kansas City group.

The district court entered findings proposed by defendants which appear to accept both of defendants' versions of this transaction.

3. In the merger consummated on December 13, 1965, Susquehanna in effect "sold" 1,274,734 newly issued shares to the Gypsum shareholders in exchange for the assets and liabilities of Gypsum. One new share of Susquehanna was issued in exchange for each 1.9 shares of Gypsum. This exchange ratio was determined by New York Hanseatic Corporation and reviewed by Stone and Webster, both being recognized as

experts in such matters, and both expressing the opinion that an exchange ratio of 1.9 to 1 was fair to both groups of shareholders.

In calculating the exchange ratio, the experts ignored Susquehanna's earnings, having determined that its "break up" value exceeded its worth as a going concern. They concluded that the total market value of its net assets [15/] was approximately $27,135,000, which was equal to $10.75 for each share outstanding. Thus, in effect, the price of the Susquehanna shares "sold" via the merger was $10.75.

In calculating the value of Gypsum's contribution to the merged enterprise, the experts capitalized its earnings. As reported in the proxy statement, Gypsum's earnings for the years 1961 through 1965 had been 4, 5, 41, 45 and 33 cents per share respectively. The experts' calculation was not, however, based on the reported earnings. They determined that the elimination of non-recurring losses and the addition of projected profits warranted an

upward adjustment in the earnings for the year ended June 30, 1965, to 56-1/2 cents per share. They then applied a capitalization rate of 10% and concluded that the Gypsum shares were worth $5.65 each. 16/ The relationship between $5.65 per share of Gypsum and $10.75 per share of Susquehanna produced the 1.9 to 1 exchange ratio.

In their report the experts also prepared a schedule showing the relationship between the market prices of Susquehanna and Gypsum for each month between January, 1964, and July, 1965. During most of those months a ratio based on comparative market values would have been more favorable to Gypsum, 17/ but in the first four months of 1965 it would have been somewhat more favorable to Susquehanna, ranging between 1.92 to 2.02 to 1 during those months.

The experts took note of the fact that one of Gypsum's major assets was its ownership of 430,000

shares of Susquehanna stock. Those shares were carried on Gypsum's books at their cost of $6,450,000 (or $15 per share). With its investment in Susquehanna valued at cost, Gypsum's stock had a book value of $2.20 per share, as reported in the proxy statement. Since, however, the experts had appraised Susquehanna stock as worth only $10.75 per share (as compared with the $15 cost on Gypsum's books), they recognized that the value of Gypsum's ownership of 430,000 Susquehanna shares should be reduced by $1,827,500 (430,000 times $4.25 per share), and that such an adjustment would reduce the Gypsum stockholders' equity to about $3,984,000,[18/] or approximately $1.53 per share. This adjustment, as well as Gypsum's heavy indebtedness, was a factor considered by New York Hanseatic in determining the 10% capitalization rate for Gypsum. It noted that Gypsum stock had been valued in the market "historically" at 13 to 18

earnings, and, therefore, the multiple of 10 was considered appropriate.[19/]

The two companies distributed a joint proxy statement, as well as a series of supplementary letters, in which they reported that the directors of both companies unanimously favored the merger. In essence, Susquehanna was contributing a strong balance sheet and a large tax loss, and Gypsum was contributing earnings potential, to a mutually beneficial combination. The proxy statement reported the conclusions of New York Hanseatic and Stone and Webster, but omitted any explanation of the basis of the experts' evaluations.

Plaintiffs contend that the proxy statement omitted, or inaccurately stated a number of material facts. They criticized the descriptions of the original Korholz purchase, of the purchase from the Kansas City group, and of the extent of Korholz's control over the management of the company and the

planning of the merger.

The merger was approved by the shareholders of both companies; 97% of the shares of Gypsum were voted affirmatively in favor of the merger and 75% of the shares of Susquehanna. Thus, over 200,000 votes more than the required 66-2/3% of the Susquehanna votes needed for approval were obtained. Approximately 25% of the shares either did not vote or voted against the merger.

II.

Defendants contend that plaintiffs were not entitled to a jury trial because (a) Ross v. Bernhard, 396 U.S. 531, 90 S.Ct. 733, 24 L.Ed.2d 729 which was decided on February 2, 1970, announced a new rule of constitutional law that is inapplicable to the trial in this case which was concluded on October 22, 1969; (b) plaintiffs' jury demand was not timely; and (c) in any event it related to only three of the 18 defendants.

We have concluded that none of these arguments is supportable.

A.

To support their contention that Ross v. Bernhard does not apply retroactively, defendants rely on DeStefano v. Woods, 392 U.S. 631, 88 S.Ct. 2093, 20 L.Ed.2d 1308. In that case the Supreme Court held that the decisions in Duncan v. Louisiana, 391 U.S. 145, 194, 88 S.Ct. 1444, 20 L.Ed.2d 491 and Bloom v. Illinois, 391 U.S. 194, 88 S.Ct. 1477, 20 L.Ed.2d 522, would not be applied retroactively. In Duncan and Bloom, the Court had upheld a defendant's right to a jury trial in serious criminal cases, including criminal contempts. The argument here is that if the constitutional right to a jury trial is not enforced retroactively in cases involving personal liberty, a fortiori, there should be no retroactivity in litigation involving mere property rights.

The argument implies that nonretroactivity

should have broader application in civil than in criminal litigation. In fact, however, "the non-retroactive application of judicial decisions has been most conspicuously considered in the area of criminal process." Chevron Oil Co. v. Huson, 404 U.S. 97, 105-106, 92 S.Ct. 349, 355, 30 L.Ed.2d 296 (1971). There is almost no suggestion in any of the cases from Linkletter v. Walker, 381 U.S. 618, 85 S.Ct. 1731, 14 L.Ed.2d 601 through Mackey v. United States, 401 U.S. 667, 91 S.Ct. 1160, 28 L.Ed.2d 404 (see especially Mr. Justice Harlan's concurring opinion, 675-702, 90 S.Ct. 1160) that this line of authority should be applied to civil litigation. Nevertheless, there are instances in which the "doctrine of nonretroactivity" has been applied in civil litigation. Chevron Oil Co. v. Huson, supra, 404 U.S. at 106, 91 S.Ct. 349.

In dealing with the nonretroactivity question, the Supreme Court has generally considered three

separate factors. The first, which we consider decisive here, is whether the rule sought to be applied establishes "a new principle of law, either by overruling clear past precedent on which litigants may have relied ... or by deciding an issue of first impression whose resolution was not clearly foreshadowed." Ibid. In this case defendants' argument assumes that Ross v. Bernhard announced a new rule of procedure because there was no pre-existing right to a jury trial in derivative litigation. This position was persuasively advanced by the majority of the Second Circuit in the opinion on which the court below relied,[20/] and by Mr. Justice Stewart in his dissent in Ross, 396 U.S. 531, 543-551, 90 S.Ct. 733, 24 L.Ed.2d 729. We think it plain, however, that we must follow the rationale of the Supreme Court's majority opinion which merely held, in agreement with a 1963 decision of the Ninth Circuit,[21/] that "the Seventh Amendment preserves to the parties

in a stockholder's suit the same right to a jury trial that historically belonged to the corporation and to those against whom the corporation pressed its legal claims." 396 U.S. at 542, 90 S.Ct. at 740. Under the analysis made in the Supreme Court's majority opinion, Ross did not establish a new principle of law. It merely resolved a conflict in the circuits consistently with the Court's interpretation of prior law.

The second factor in deciding the retroactivity question is whether, weighing the merits and demerits in each case, retrospective application will further or retard operation of the rule. The third requirement is that we weigh the possible inequities of retroactive application. Since there were conflicting rules in circuits, the defendants knew that the issue was not settled and that the district court might be reversed on appeal. They were certainly aware of the Ninth Circuit's

decision in the DePinto case, as well as the fact that a member of the Second Circuit panel in Ross v. Bernhard had filed a dissenting opinion. It is therefore, no more inequitable here than in any other case presenting an unsettled question of law to require defendants, who could have avoided the issue by consenting to a jury trial, to bear the risk of reversal on appeal. Moreover, our appraisal of the disclosures pertaining to the exchange of 140,000 shares of Vanadium Corporation stock for 222,107 shares of Susquehanna persuades us that it would not be inequitable to retry this case. Finally, we fail to see how retroactive application will retard operation of the rule. Thus, though we consider the first criterion decisive, we have also considered and rejected any claim of nonretroactivity based on the second and third criteria.

The basic reason for holding that a new rule

will not be applied retroactively is to avoid unfairness to parties who may have acted in reliance on the old rule.[22/] In this case, however, defendants do not seek to justify any aspect of their conduct of the three transactions challenged by plaintiffs by claiming reliance on a rule which antedated the Supreme Court decision in Ross v. Bernhard. Nothing more than trial tactics was involved in their motion to strike the plaintiffs' jury demand. This is not one of the exceptional situations in which a holding of nonretroactivity is required to avoid consequences akin to the enactment of an ex post facto law.

We hold that plaintiffs were entitled to demand a jury trial of any legal claims historically triable to a jury which they have asserted against defendants on behalf of Susquehanna Corporation.

B.

Defendants contend that plaintiffs' jury

demand was not timely. It was filed more than 38 months after the original complaint and several months after all defendants had answered. It was incorporated in a reply which itself was not filed within the time specified by the court.

Defendants rely on cases holding that after the right to a jury trial has been waived, the right cannot be revived by a belated amendment to the pleadings which does not raise any new issues.[23/] However, a review of the proceedings in this case persuades us that there was no point in time when it could fairly be said that plaintiffs had waived their right to demand a jury.

Rule 38(b) permits a party to postpone decision on whether or not to demand a trial by jury until after the issues to be submitted to the jury have been finally framed by the pleadings.[24/] Presumably, that is the reason the timeliness of a jury demand is measured from the filing of the

"last pleading directed to such issue," and also why amendments which do not really change the issues do not revive a right that has been waived.

In this case plaintiffs cannot be charged with sole responsibility for the time which elapsed before the case was finally at issue. The sufficiency of Count I of the complaint was tested by motions to dismiss which led to the first appeal to this court. After the remand, defendants filed their answers in February and March of 1968. Plaintiffs promptly moved to strike several portions of the answers, including parts of all five affirmative defenses asserted by defendants Korholz, Gypsum and Susquehanna. Those motions raised substantial questions which were briefed at length and led to the entry of an order on October 21, 1968, in which the court struck portions of the affirmative defenses and granted plaintiffs leave to file a reply by December 1, 1968. The reply was not

actually filed until December 30, 1968, but no objection to its filing was made at that time.

If the reply had been filed on December 1, 1968, quite clearly it would have been the "last pleading" within the meaning of Rule 38(b). Up to that time there had been no final definition of the issues and no waiver of the right to a jury trial. By permitting the reply to be filed on December 30, 1968, the trial court effectively extended the time for filing the "last pleading," and thus the time in which to demand a jury.

When the district court sustained the motion to strike the jury demand, he placed no reliance on its late filing. Commendably he made it perfectly clear that his ruling was based on the Second Circuit decision in Ross v. Bernhard, and he indicated at the hearing on the motion that if the law permitted a jury trial in a derivative action, he would not have rejected the demand as untimely.

We hold that plaintiffs did not waive their right to a jury trial.

C.

The pleading which included the jury demand was identified as a reply to the affirmative defenses of only three of the defendants. It is, therefore, contended that the demand should be construed as limited to the issues raised in the affirmative defenses of those three defendants.

Even as so construed, however, it is clear that basic issues in the litigation were encompassed by the reply and, therefore, by the jury demand incorporated therein. The affirmative defenses squarely raised the question whether Susquehanna had been damaged by any of the alleged misconduct of the defendants, the question whether the merger exchange ratio was fair, and other important issues.

The broad language of the jury demand plainly indicated that plaintiffs wanted a jury trial of all issues which could properly be submitted to a

jury. Defendants other than Korholz, Gypsum and Susquehanna construed the demand as applicable to them because they also filed a motion to strike. The trial judge viewed the problem as whether any jury trial was appropriate in a derivative action, and does not appear to have considered the possibility of separating out certain issues for the jury. We have no doubt that if the trial judge had had the benefit of the later Supreme Court opinion in Ross v. Bernhard, he would not have construed the demand in the restrictive manner which defendants urge here. Assuming that the demand was timely, as we have held, we think a fair construction of its broad language would cover all issues that plaintiffs are entitled to have tried by a jury. We, therefore, must identify those issues.

III.

Although the holding in Ross v. Bernhard makes it plain that plaintiffs, who are suing

derivatively on behalf of Susquehanna, have "the same right to a jury trial that historically belonged to the corporation," 396 U.S. at 542, 90 S.Ct. at 740, 24 L.Ed.2d 729, in that case the Supreme Court was not required to define the scope of that right. The opinion recognizes the possibility that some breaches of fiduciary duty by corporate directors may not be triable to a jury;[25/] the reference to history in the statement of the holding implies that claims which are traditionally regarded as equitable in character may properly be heard by the court.

It is important to state the claims asserted by plaintiffs as precisely as possible, not only because we must differentiate between legal and equitable claims, but also because the relevant law is still in an embryonic stage of development and the Supreme Court has admonished us not to stunt its growth with "glib generalizations and

unthinking abstractions."[26] We shall, therefore, first consider the two claims which we held sufficient on the prior appeal and then turn our attention to the several other claims which are included in the complaint as finally amended.

For purposes of identification we shall refer to the two principal claims as Susquehanna's (a) "purchase" and (b) "sale" of its own shares. The "purchase" was the acquisition of 222,107 shares from the Kansas City group in exchange for the block of Vanadium stock, and the "sale" was the issuance of 1,274,734 new shares to the former Gypsum shareholders at the time of the merger.

Also for identification purposes, we may list the additional claims which merit discussion as (1) the claim that the Lannan defendants received a premium for selling control of Susquehanna to Korholz; (2) a claim that §10(b) and Rule 10b-5 were violated by failure to disclose the

the contemplated transfer of control before it took place; (3) a claim that the Lannan directors did not adequately investigate the qualifications of Korholz to be an officer and director of Susquehanna before his election; (4) a claim that the court should appoint a disinterested arbiter to redetermine the merger exchange ratio; and (5) a claim that deficiencies in the pre-merger proxy statement required that the merger be set aside.

We turn to the two claims for damages.

A. Susquehanna's "purchase" of its own stock.

Federal jurisdiction was properly invoked in this case because the complaint alleged violations of three federal statutes.[27/] Of these three, it is §10(b) of the Securities Exchange Act of 1934, and more particularly Rule 10b-5, that has most direct relevance to the claim that Susquehanna was damaged by paying too much in connection with the purchase of its own shares from members of the

Kansas City group in August of 1965. The Rule plainly affords protection to both sellers and purchasers.[28/] A private party injured by a violation of the Rule may either rescind his purchase or sale or recover his damages in an action at law.[29/] It seems clear that a jury trial is appropriate in such a damage action.[30/]

In this case there is no doubt that Susquehanna's acquisition of its own shares in exchange for its block of Vanadium stock was a "purchase" within the meaning of the Rule. Plaintiffs contend that as a direct consequence of fraud or deceit proscribed by the Rule, the purchase was made at a price which was unfair to Susquehanna.[31/]

The perpetrators of the alleged fraud included several of the directors of Susquehanna. Since the challenged transaction did not require shareholder approval, the directors would normally speak for the corporation in connection with the

matter. To the extent that the directors were competent to act for the corporation, it therefore would follow that Susquehanna was the victim of its own fraud.

This theoretical dilemma has been met in other cases by recognizing that defendant directors may deceive disinterested members of the board, and through them the corporation.[32/] Plaintiffs relied on that theory in the presentation of their evidence and in their argument here. However, a different theory is embodied in the complaint.

The complaint alleges that the entire board was interested in the transaction and, therefore, was not competent to authorize the purchase by the corporation. Accordingly, it is contended that defendants were under a duty to make full disclosure of their adverse personal interests to the shareholders, and that the failure to make that disclosure, or to advise the shareholders that the

exchange actually cost Susquehanna $682,500, constituted a fraud or deceit prohibited by Rule 10b-5. The sufficiency of that claim is established as the law of this case, see 380 F.2d 262 at 269-270, and we are satisfied that insofar as a damage recovery is sought, the allegations raise issues triable to a jury.

It does not necessarily follow that the case should be remanded for a new trial on those issues. For if the evidence which plaintiffs adduced at the trial before the court was not sufficient to prove a prima facie case, the denial of a jury trial was harmless error. We shall, therefore, consider whether the record contains evidence tending to prove that Susquehanna was deceived, that there was a causal connection between the deception and the purchase, and that it was damaged thereby.

Although the trial judge, after weighing the evidence, rejected the inferences which plaintiffs

draw from the facts, we cannot say that either of defendants' versions of the transaction is so clearly correct that plaintiffs' proof failed as a matter of law. Defendants contend that the block of Vanadium stock had no greater value to Susquehanna than the current market because the shares could not be voted while owned by Susquehanna and that, in any event, the benefits received by Susquehanna from the settlement of the pending litigation with Vanadium and the elimination of potential dissention within Susquehanna's top management more than offset the premium value of the Vanadium stock (and thus the true over-the-market cost of the purchased Susquehanna shares). If either of these factual propositions is correct, the purchase did not injure Susquehanna and the damage action must fail. But there is certainly evidence in the record from which a jury could conclude that Susquehanna could have realized a premium -- possibly the full

$682,500[33/] -- on a sale of the Vanadium stock to a third party or to Vanadium itself, and further, that making peace with the Kansas City group did not necessarily produce a corporate benefit of comparable value. The evidence on the damage issue is, therefore, sufficient for submission to a jury.

There is also evidence tending to prove that material facts were not disclosed to Susquehanna (either to the shareholders or to all of the directors voting on the matter), and that the purchase might not have been consummated on the same terms if full disclosure had been made.

If plaintiffs' version of the transaction is correct, the purchase resulted in a net injury to Susquehanna of approximately $682,500. Neither this fact nor the fact that a threat of litigation was avoided by making the exchange was ever disclosed to the shareholders. Such nondisclosure would not violate Rule 10b-5, however, if a

disinterested majority of the board of directors was fully informed about all relevant facts, and if in good faith exercise of their business judgment they concluded that the transaction was in the best interests of the corporation.[34/] For on that hypothesis, since a disinterested majority of the board would have the authority to consummate the transaction, the disclosures within the board would constitute disclosure to the corporation.

A violation of Rule 10b-5 did result, however, if either of two factual propositions is established by the evidence. First, if material facts were misrepresented or withheld from some members of the board of directors, the corporation was deceived. Ruckle v. Roto American Corporation, 339 F.2d 24 (2nd Cir. 1964). Second, if the entire board of directors was interested in the transaction, a duty of disclosure to the shareholders existed,[35/] and the corporation was deceived by the nondisclosure.

Although it is not entirely clear that the second proposition has enough evidentiary support to justify submission to a jury,[36/] there is substantial evidence in the record tending to prove that there was inadequate disclosure, and possibly actual misrepresentation, of material facts within the board of directors.[37/] The evidence of fraud or deception was thus sufficient to raise an issue for the jury.

Finally, we are persuaded that if the jury should accept plaintiffs' appraisal of the true impact of the transaction on Susquehanna, and if it should conclude that some of the directors were misled by Korholz, it would also be entitled to find a causal connection between the fraud and the injury. We, therefore, hold that plaintiffs are entitled to have a jury decide the issues raised by their claim that the purchase of 222,107 of its shares from the Kansas City group in July of 1965 resulted in damage, possibly as much as $682,500

to Susquehanna.

B. Susquehanna's "sale" of its own shares.

From Susquehanna's point of view, the statutory merger involved a sale of 1,274,734 of its own shares, and a purchase of 2,421,996 shares of Gypsum. SEC v. National Securities, Inc., 393 U.S. 453, 467-468, 89 S.Ct. 564, 21 L.Ed.2d 668; Dasho v. Susquehanna Corp., 380 F.2d 262 at 268-269, cert. denied, 389 U.S. 977, 88 S.Ct. 480, 19 L.Ed.2d 470; Swanson v. American Consumer Industries, Inc., 415 F.2d 1326, 1330 (7th Cir. 1969). Since interstate facilities were employed to consummate the exchange, the merger was a "securities transaction" covered by Rule 10b-5.

If it was the product of fraud or deception proscribed by the Rule, and if Susquehanna thereby suffered a pecuniary injury, a cause of action for damages may be prosecuted by plaintiffs on behalf of the corporation. Under Ross v. Bernhard, we

believe such a claim would be triable to a jury. Before analyzing other elements of the claim, it is appropriate to consider the damage issue; unless the record contains evidence on which an award of damages could be based, a jury trial may be unnecessary and our review may be limited to determining whether the district court findings on the issue of liability are clearly erroneous.

We find nothing in the record to suggest that Susquehanna should not have been merged with a profitable corporation in order to take full advantage of its tax loss. Nor do we find any evidence indicating that Gypsum was not an appropriate component of such a merged enterprise, or that a more favorable opportunity was lost because of the Gypsum merger. Thus, neither the fact that the merger took place, nor the fact that it was Gypsum that was merged into Susquehanna, appears to have caused any injury to Susquehanna.

Nevertheless, it is possible that the terms of the merger may have damaged Susquehanna. Even if it was wise to sell its shares to obtain Gypsum's earnings, Susquehanna may have been fraudulently induced to accept an inadequate price per share and therefore to issue too many shares.

For purposes of analysis we may assume that Susquehanna solds it own shares for a price of $10.75 per share and purchased Gypsum shares for a price of $5.65 per share. If either the former price was too low, or the latter price was too high, and if no compensating adjustment in the other is appropriate, Susquehanna was damaged. In other words, if the exchange ratio was unfair to Susquehanna, it was injured by the merger.

The district court found that the exchange ratio was fair. All the directors so testified, and plaintiffs offered no expert testimony to the contrary. The finding is further supported by

the opinions of New York Hanseatic Corporation and Stone and Webster. Even though the finding is not clearly erroneous, indeed even if we would enter the same finding ourselves, it does not follow that the record contains no evidence from which a jury might have come to a different conclusion.

If the jury could properly find that Susquehanna's approval of the terms of the merger was obtained by fraud, and that a full disclosure of all material facts would have required an adjustment of those terms in order to obtain the necessary authorization to consummate the transaction, the conclusion that the corporation was in fact damaged by the fraud would be supportable. Assuming the existence of a violation and consequent injury, the question would then be whether the record contains any evidentiary basis for a reasonable calculation of the amount of that pecuniary injury.

Of course, damages may not be the product of

pure conjecture or speculation. See Bigelow v. RKO Radio Pictures, 327 U.S. 251, 264, 66 S.Ct. 574, 90 L.Ed. 652. A jury cannot be permitted to make a random selection of any exchange ratio that might appeal to it. But if we assume that all other elements of the claim, except the amount of damages, have been adequately established, the same standards that juries employ to determine comparable issues in other complex commercial litigation would permit recovery here if the evidence provides a reasonable basis for measuring the injury. On that assumption, we have concluded that the record does contain evidence from which a jury could select an acceptable measure of damages.

It is not inconceivable that arm's length bargaining between fully informed representatives of Gypsum and Susquehanna would have produced an exchange ratio predicated on comparative market values during the months immediately preceding Gypsum's

$6,450,000 investment in Susquehanna.[38/] For each of the four months prior to May of 1965 such an approach would have produced a more favorable ratio for Susquehanna than 1.9 to 1. Viewing the transaction broadly, if, for example, the ratio of 2.02 to 1 or 1.96 to 1 had been used instead of 1.9 to 1, it could not be said that the total price paid by Susquehanna to acquire Gypsum's assets and earnings was beyond a tolerable range of fairness.[39/] For on a 2 to 1 basis, assuming with the experts that Susquehanna's shares were worth only $10.75 apiece, it would have paid an aggregate price of approximately $13,000,000[40/] for earnings of $814,000, as audited (or $1,374,000, as adjusted) and net assets of $3,984,000.[41/]

We by no means suggest that this is the proper measure of damages in this case. Nor do we imply that market values are a better determinant of exchange ratios than expert appraisals. We merely

hold that they provide a permissible measure from which a jury may estimate the amount of pecuniary damages which a defrauded party has suffered. We, therefore, conclude that if the record contains evidence tending to prove the other elements of plaintiffs' cause of action predicated on the merger, the claim for damages may be submitted to a jury. We now consider those other elements.

Plaintiffs must, of course, prove a violation of law by the defendants and a causal connection between the violation and an injury to Susquehanna. Plaintiffs have argued that there were several deficiencies in the proxy solicitation which violated SEC Rule 14a-9, implementing §14(a) of the 1934 Act and that the causation issue is settled by Mills v. Electric Auto-Lite, 396 U.S. 375, 90 S.Ct. 616, 24 L.Ed.2d 593. We are convinced that at least one of their attacks on the proxy statement raises a triable issue of fact, but we are not sure that Mills

disposes of the causation issue in an action for damages. We first consider the violation.

The relevant language of Rule 14a-9 is similar to that found in Rule 10b-5[42/] and §29(a). The proxy solicitation was unlawful if it contained "any statement which ... is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading...." If a jury should agree with plaintiffs' version of the transaction in August 1965 (when Susquehanna used its block of Vanadium stock to purchase 222,107 of its own shares), it could also properly conclude that the description of that transaction in the proxy statement was misleading.[43/] If plaintiffs' analysis is correct, the proxy statement falsely advised the shareholders that a purchase by Susquehanna of approximately $3,000,000 worth of its own shares had been made on a "market to

market" basis when in fact a premium of $682,500, amounting to about $3 per share, was paid. The magnitude of the transaction, the fact that it related directly to the value of Susquehanna shares (and therefore to the fairness of the bargain which was the subject of the proxy statement), and the character of the omission or misstatement, all satisfy the test of materiality as stated by the Second Circuit in General Time Corporation v. Talley Industries, Inc.[44/] To the extent that intent is relevant, the evidence is adequate.[45/] Plainly, then, there was sufficient evidence of a violation to be submitted to a jury.

On the question of causation, there is no doubt that the proxy solicitation was an essential link in the accomplishment of the merger. Apart from the solicitation, there is no contention that defendants could have mustered the necessary two-thirds vote required for the approval of the

merger. The following language in the Mills opinion may, therefore, determine the causation issue:

> "Where the misstatement or omission in a proxy statement has been shown to be 'material' as it was found to be here, that determination itself indubitably embodies a conclusion that the defect was of such a character that it might have been considered important by a reasonable shareholder who was in the process of deciding how to vote. This requirement that the defect have a significant propensity to affect the voting process is found in the express terms of Rule 14a-9, and it adequately serves the purpose of ensuring that a cause of action cannot be established by proof of a defect so trivial, or so unrelated to the transaction for which approval is sought, that correction of the defect or imposition of liability would not further the interests protected by §14(a).
>
> "There is no need to supplement this requirement, as did the Court of Appeals, with a requirement of proof of whether the defect actually had a decisive effect on the voting. Where there has been a finding of materiality, a shareholder has made a sufficient showing of causal relationship between the violation and the injury for which he seeks redress if, as here, he proves that the proxy solicitation itself, rather than the particular defect in the solicitation materials, was an essential link in the accomplishment of the transaction." 396 U.S. at 384-385, 90 S.Ct. at 621.

There are two reasons why quotation of that language out of its context does not necessarily eliminate the causation issue of this case. In Mills the plaintiffs were seeking equitable relief, not damages as plaintiffs do here. In Mills, apart from any question of the fairness of the exchange ratio, plaintiffs sought to vindicate their right to be shareholders of a separate company rather than a larger, combined enterprise;[46/] here the merger itself was apparently unobjectionable[47/] and a damage award must, in effect, depend on a revision of the exchange ratio. Thus, although the Mills holding would seem to require a finding of "legal injury" caused by the violation, in this case that injury may not include any pecuniary loss.[48/]

In short, we think Mills takes us this far: If plaintiffs prevail on the issue of materiality, they have also established that approval of the

1.9 to 1 exchange ratio was unlawfully obtained. But that approval caused Susquehanna monetary injury only if (a) Susquehanna would have been better off with no merger at all; or (b) a more favorable exchange ratio would have been available if there had been full disclosure. The first alternative is not supported by any evidence which has been called to our attention; the second requires an evaluation of the transaction from Gypsum's point of view as well as Susquehanna's. For if it were plain from the record that Gypsum's shareholders would not in any event have approved a merger on terms which required surrender of more than 1.9 of their shares for each Susquehanna share, then approval of those terms, even if unlawfully obtained, did not harm Susquehanna.

Plaintiffs argue that Gypsum was under significant economic pressure to effect the merger because of its heavy indebtedness and its commitment

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to repay the $6,450,000 bank loan promptly after the completion of the merger. They contend, therefore, that arm's length bargaining would have produced a more favorable ratio for Susquehanna without precluding the likelihood that Gypsum's shareholders would have approved of the merger on different terms. The district court found this argument unpersuasive, but we cannot say that it is so lacking in evidentiary support that it does not warrant consideration by the trier of fact.

Accordingly, we conclude that there is evidence in the record from which a jury might find (1) that material facts were misstated or omitted from the proxy materials in violation of federal law; (2) that the violation caused the shareholders of Susquehanna to approve the merger on the terms submitted; (3) that terms which would have been more favorable to Susquehanna might have been sufficiently attractive to the Gypsum shareholders to make it

reasonable to conclude that they would have given their approval to different terms; and (4) that the record contains relevant data from which a jury might make a just and reasonable estimate of the amount of Susquehanna's damage. We, therefore, hold that plaintiffs are entitled to have a jury decide the issues raised in their claim for damages predicated on the merger.

IV.

In our opinion, plaintiffs' remaining claims are all equitable in character. Two relate to the merger and three to Korholz's original purchase in May.

With respect to the merger, plaintiffs prayed that it either be set aside or that an independent arbiter be appointed to redetermine the exchange ratio. The record makes it quite clear that neither of these forms of relief would be feasible or appropriate. The merger itself (as opposed to its

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terms) does not appear to have harmed Susquehanna or its shareholders, and it is far too late to permit an arbiter to remake the bargain which the minority shareholders of Gypsum accepted.

With respect to the sale of 430,000 shares to Korholz, plaintiffs advance three theories of recovery, each of which is predicated on a version of the transaction which the district court rejected. Plaintiffs argue that certain findings with respect to the alleged transfer of control from Lannan and his associates to Korholz are clearly erroneous, or at least could be shown to be erroneous if admissible evidence had not been improperly excluded. For purposes of considering these claims, we assume, without deciding, that the evidence should have been received and that plaintiffs' version of the transaction is essentially correct.

They contend that Korholz's payment of $6,450,000 was not merely a purchase of shares

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but included the payment of a premium of about $1,075,000 to obtain working control of Susquehanna. He would not have paid that price unless he had been sure of adequate representation on the board, including election as its chairman. After his election, his position, coupled with his stock ownership, enabled him to exercise "working control" of the corporation. Assuming these facts as proved, we consider plaintiffs' three theories of recovery.

A. First relying on SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2nd Cir. 1968), cert. denied, Coates v. Securities and Exchange Commission, 394 U.S. 976, 89 S.Ct. 1454, 22 L.Ed.2d 756, plaintiffs contend that Rule 10b-5 was violated when the Lannan directors sold their shares on the basis of "material inside information" which they possessed and which they had a duty to disclose to the public. The inside information was the fact that Korholz had offered to pay them $15 per share for a block of

430,000 shares.

We would agree that if the directors, having knowledge of such an offer, had purchased shares at a lower price on the open market in order to assemble a block to be sold to Korholz at the premium price, those purchases on the open market would be securities transactions covered by Rule 10b-5. We find no evidence of any such purchases; nor is there any evidence that the plaintiffs, or any member of the class they represent, engaged in any purchase or sale of Susquehanna stock which would have been more favorable if the Korholz offer had been disclosed before his purchase from Lannan was consummated, or that anyone failed to engage in any favorable transaction as a result of the nondisclosure.

We do not believe Rule 10b-5 imposes an obligation on controlling shareholders to make prompt disclosure of every offer they receive,[49/] and find

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no evidence that an earlier disclosure of the Korholz offer would have benefitted plaintiffs in any way. We, therefore, conclude that the district court correctly rejected plaintiffs' first contention.

B. Plaintiffs also contend that the Lannan directors did not make an adequate investigation of Korholz before electing him to the board. They argue that a full investigation would have revealed that he was purchasing the stock on behalf of Gypsum, that he was already planning a merger, and that as a consequence of the merger Susquehanna would provide the funds which were used to pay $6,450,000 to the Lannan group.

To the extent that this argument is advanced to support the prayer that Korholz's election as a director should be declared null and void, it is foreclosed by findings of fact to the effect that adequate investigation of his character, reputation, and experience was made. Those findings are

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supported by the record.

To the extent that the argument relates to the consequences of the merger, we believe it is subsumed by plaintiffs' second damage claim. If neither the merger itself nor its terms damaged Susquehanna, the fact that assets of the merged enterprise were used to discharge a liability of the merged enterprise certainly did not damage either of its components.

C. Finally, in their reply brief plaintiffs have directed our attention to Keely v. Black, 90 N.J.Eq. 439, 107 A. 825 (N.J. Ch. 1919), and certain other state cases to support the suggestion that the premium received by a director in connection with the sale of a controlling block of stock should be treated as an asset of the corporation. The rule of that case is not a matter of federal law or, so far as we have been advised, the law of the state in which either Susquehanna or

Gypsum was incorporated. Even if Lannan's shares constituted control of Susquehanna, we believe he had a right to sell them for a premium price. See Essex Universal Corp. v. Yates, 305 F.2d 572 (2nd Cir. 1962).

Defendants Lannan, Lauhoff and Schmick are not responsible for actions taken by other defendants or by the board of directors after their respective resignations. The death of defendant Michels has been suggested of record. Accordingly, insofar as the district court judgment dismissed the claims against Lannan, Lauhoff, Schmick and Michels, it is affirmed. As to the other defendants, the judgment is reversed and the case is remanded for a jury trial.

FOOTNOTE INDEX

Opinion of the United States Court of Appeals
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Appendix C

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1/ 15 U.S.C. §77q.

2/ 15 U.S.C. §78j.

3/ 15 U.S.C. §78n.

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4/ Lannan, Lauhoff and Wirtz resigned from the board on May 18, 1965, and sold all of their Susquehanna stock a week later. Schmick and Bard also sold all of their stock but did not resign until June 18 and July 15, respectively. Wirtz and Bard were voluntarily dismissed by plaintiffs on the first day of trial; Lannan, Lauhoff and Schmick contend that they have no responsibility for what happened after their resignations from the board.

5/ Schenk, Bogan, Boshell, May, Michels, Stuart, Mason and Woolard were members of Lannan's management slate and remained on the board, and continued to own Susquehanna stock until after the merger. Mason owned only 100 shares; he was the third defendant voluntarily dismissed by plaintiffs.

6/

Martin and Thomson were the two directors elected by a group of shareholders who were apparently customers of a broker in Kansas City named Coen. They had no advance knowledge or participation in the original sale of 430,000 shares to Korholz, but were familiar with the transaction with Coen in August and the merger in December.

7/

Korholz is the principal defendant. Hardin, Nielsen and Reeves were his nominees to replace the members of the Lannan management who resigned on May 18, 1965 or shortly thereafter. Gypsum, the corporation of which Mr. and Mrs. Korholz owned or controlled 57% before its merger into Susquehanna, is also a defendant.

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8/

Thus, for example, Bogan, who owned or controlled 56,152 shares at the time of the annual meeting in April, delivered about 65,000 shares into the package and still retained 13,986 shares on September 15, 1965, according to the proxy statement. Woolard, who retained his own holding of 16,800 shares, sold approximately 70,000 shares for his associates.

9/

Seven of the remaining directors owned a significant number of shares after the Korholz purchase, ranging, at the time the proxy statement for the merger was prepared, from 64,229 for Michels and 47,260 for May, to 2,147 for Schenk, the company president.

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10/ It promptly sent a letter to its shareholders reporting that it had made a favorable purchase of those shares at a price of $24.125 per share, a price which, though over the current market, was less than book value.

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11/ The net amount received by the Kansas City group ($3,076,815) divided by the number of Susquehanna shares delivered (222,107) equals a price of $13.85.

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12/ Thus, the difference between the maximum purchase of 250,000 shares and the 222,107 shares actually delivered accounts for the cash distribution to Susquehanna of $300,685.

13/ See Vanadium Corp. of America v. Susquehanna Corp., 203 F.Supp. 686, 697 (D. Del. 1962).

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14/ Coen, representing the Kansas City group, addressed a letter to the Susquehanna directors threatening to commence litigation to recover the premium portion of the price received by Lannan and the other selling parties in May and to

enjoin Korholz and his associates from acting as directors and from voting any of the shares purchased from Lannan. Korholz thereafter proposed the exchange of Vanadium stock for the stock represented by Coen. After the exchange was authorized by the Susquehanna board on July 15, 1965, Korholz introduced Coen to the Vanadium principals with whom he negotiated the resale. He formally withdrew his threat of litigation by letter of August 10.

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They treated a federal income tax loss carryover as an "asset" with a value of about $2,900,000. The gross amount of the carryover was reported in the proxy statement at $14,400,000 as of December 31, 1964.

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16/

Gypsum's "adjusted earnings for the 12 months ended June 30, 1965" as determined by the experts were $1,374,000 (PX 72 p. 8). Applying the capitalization rate of 10%, they thus assumed that the value of Gypsum's contribution to the merged enterprise was approximately $13,740,000 as compared with their appraisal of Susquehanna's "break up" value at approximately $27,135,000.

17/

Thus, for example, in January of 1964 the ratio would have been 1.15 to 1 and in July of 1965, 1.62 to 1.

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18/ The experts' opinion does not give complete details on how this figure was arrived at, but we accept it as accurate enough for our purposes.

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19/ They made no comment on the fact that the conservative multiple of 10 times the adjusted earnings of 56-1/2 cents produced a higher value than a liberal multiple of 17 times the audited earnings of 33 cents per share.

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20/ Ross v. Bernhard, 403 F.2d 900 (2nd Cir. 1968) but see Smith, C.J., dissenting at p. 915.

21/ DePinto v. Provident Security Life Ins. Co., 323 F.2d 826, cert. denied, 376 U.S. 950, 84 S.Ct. 969, 11 L.Ed.2d 970.

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22/ See, Schaefer, The Control of "Sunbursts": Techniques of Prospective Overruling, 42 N.Y.U.L.R. 631 (1967); Fairchild, Limitation of New Judge Made Law to Prospective Effect Only: "Prospective Overruling" or Sunbursting, 51 Marquette L.R. 254, 257 (1967-68).

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23/

See Moore v. United States, 196 F.2d 906, 908 (5th Cir. 1952); Connecticut General Life Ins. Co. v. Breslin, 332 F.2d 928, 931 (5th Cir. 1964); Leighton v. New York Susquehanna & Western R.R., 36 F. R.D. 248, 249 (S.D.N.Y. 1964).

24/

Rule 38(b) provides:

> "(b) Demand. Any party may demand a trial by jury of any issue triable of right by a jury by serving upon the other parties a demand therefor in writing at any time after the commencement of the action and not later than 10 days after the service of the last pleading directed to such issue. Such demand may be indorsed upon a pleading of the party."

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"In the instant case we have no doubt that the corporation's claim is, at least in part, a legal one. The relief sought is money damages. There are allegations in the complaint of a breach of fiduciary duty, but there are also allegations of ordinary breach of contract and gross negligence. The corporation, had it sued on its own behalf, would have been entitled to a jury's determination, at a minimum, of its damages against its broker under the brokerage contract and of its rights against its own directors because of their negligence. Under these circumstances it is unnecessary

to decide whether the corporation's other claims are also properly triable to a jury. Dairy Queen, Inc. v. Wood, 369 U.S. 469 (82 S.Ct. 894, 8 L.Ed.2d 44) (1962)." 396 U.S. at 542-543, 90 S.Ct. at 740.

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"Although §10(b) and Rule 10b-5 may well be the most litigated provisions in the federal securities laws,this is the first time this Court has found it necessary to interpret them. We enter this virgin territory cautiously. The questions presented are narrow ones. They arise in an area where glib generalizations and unthinking abstractions are major occupational hazards. Accordingly, in deciding this particular case, remembering what is not involved is as important as determining what is." SEC v. National Securities, Inc., 393 U.S 453, 465, 89 S.Ct. 564, 571, 21 L.Ed.2d 668.

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See footnotes 1, 2 and 3, supra.

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28/

Supt. of Ins., State of New York v. Bankers Life & Cas Co., 404 U.S. 6, 92 S.Ct. 165, 30 L.Ed. 2d 128 (1971); Birnbaum v. Newport Steel Corp., 193 F.2d 461, 463 (2nd Cir. 1952). Rule 10b-5 provides:

"It shall be unlawful for any person, directly or indirectly by the use of any means

or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

"(a) To employ any device, scheme, or artifice to defraud,

"(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."
17 C.F.R. §240.10b-5 (1971).

29/ The Supreme Court has clearly indicated that its holding in J. I. Case Co. v. Borak, 377 U.S. 426, 84 S.Ct. 1555, 12 L.Ed.2d 423, encompasses an action for damages. See Bivens v. Six Unknown Named Agents of Federal Bureau of Narcotics, 403 U.S. 388, 397, 91 S.Ct. 1999, 29 L.Ed.2d 619. Note also the comment by Mr. Justice Harlan in his concurring opinion at p. 402, 91 S.Ct. at p. 2008:

"Thus, in suits for damages based on violations of federal statutes lacking any express authorization of a damage remedy, this Court has authorized such relief where, in its view, damages are necessary to effectuate the congressional policy underpinning the substantive provisions of the statute. J. I. Case Co. v. Borak, 377 U.S. 426 (84 S.Ct. 1555, 12 L.Ed. 2d 423) (1964);..."

30/ See, e.g., Myzel v. Fields, 386 F.2d 718, 740-741 (8th Cir. 1967), cert. denied, 390 U.S. 951, 88 S.Ct. 1043, 19 L.Ed.2d 1143; Esplin v. Hirschi, 402 F.2d 94, 95 (10th Cir. 1968), cert. denied, 394 U.S. 928, 89 S.Ct. 1194, 22 L.Ed.2d 459. See also, Dairy Queen, Inc. v. Wood, 369 U.S. 469, 477-479, 82 S.Ct. 894, 8 L.Ed.2d 44.

31/ The price paid for the Susquehanna shares may, of course, properly be measured by the value of the consideration delivered to the seller by the purchaser. See Mueller v. Korholz, 449 F.2d 82, 86, 88 (7th Cir. 1971).

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32/ Ruckle v. Roto American Corp., 339 F.2d 24 (2nd Cir. 1964). See also Supt. of Ins. of State of New York v. Bankers Life & Cas. Co., 404 U.S. 6, 92 S.Ct. 165, 30 L.Ed2d 128 (1971).

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33/ The actual damages need not be the full $682,500. If Susquehanna itself could have sold only for a lesser premium, that lesser premium would be the measure of damages. Or, if the jury valued the benefits received as greater that the market value of the Susquehanna shares but less than the full value of the Vanadium shares sold, the difference would be the damage recoverable.

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34/

Kors v. Carey, 39 Del.Ch. 47, 158 A.2d 136, 139, 141 (Del. 1960); Warshaw v. Calhoun, 221 A.2d 487 (Del. 1966).

35/

See 380 F.2d at 270.

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36/

Most of the directors apparently owed no special allegiance to Korholz. There appear to be three aspects of the "interest" of such directors in the transaction involving Vanadium stock: (1) to remove possible opposition to the Gypsum merger; (2) to eliminate dissension within the board; and (3) to avoid Coen's threatened litigation. The first two aspects of their interest would not conflict with their status as shareholders or directors. The third aspect might, however, if the evidence indicated that the director was a potential defendant in the threatened litigation and that it was reasonable to infer that the threat was of sufficient importance to influence his action as a director. The marginal character of the exposure of certain directors, when compared with the substantial character of their interest as shareholders in the welfare of the corporation (Michels, for example, owned over 64,000 shares), makes it extremely doubtful that their independence was compromised by the threat contained in Coen's letter of June 17, 1965, which can be read as not contemplating any claim at all against some members of the board. However, since plaintiffs will have

ce right to offer additional evidence at the re-
rial, and since we may have overlooked evidence
hich the trial judge might consider significant,
e do not squarely decide the issue. We believe it
s probably in the area in which we would respect
he trial judge's discretion, whichever way he
uled, because of his superior ability to evaluate
he evidence as it is actually presented.

5/ For example, the minutes of the July 15, 1965
eeting of the Susquehanna board of directors con-
ains the following:

"It was further reported to the Board that efforts had been made by Susquehanna without success to sell its Vanadium shares for a price in excess of market. Those shares were recently offered by Mr. Korholz and Mr. William L. Brown of The First National Bank of Boston to International Mining Corporation, as well as to Vanadium on that basis, but both such corporations had rejected the offer.

"Mr. Korholz then reported that with the consent of the Executive Committee he had discussed with Mr. M. J. Coen of Kansas City, a possible exchange of the Vanadium shares for 250,000 shares of Susquehanna said to be owned by Mr. Coen and customers or his associates. Such discussion had resolved itself into a possible exchange on the basis of market values since Mr. Coen refused to pay a substantial premium for the Vanadium shares unless a comparable premium was paid for his block of Susquehanna shares." PX 1-R, pp. 5-6.

If this were all that was disclosed, and if Korholz had been aware of the possibility of Vanadium Corporation itself buying the stock at a premium, the jury could certainly conclude that he withheld such information from other members of the board in order to arrange the premium for Coen and persuade Coen to withdraw threatened litigation. There was also testimony that Korholz had previously called Coen and asked him "whether he wanted to make some money on his investment or whether he just wanted to raise hell." (Tr. 447). And further, "(F)irst of all, get rid of this letter (threatening litigation) and then I will do it, we can work quietly on some program that gets you what you want as long as it is within reason and gets me what I want for the company." (Tr. 451). Following the July 15 meeting, Korholz accompanied Coen to New York and introduced him to Harder, a Vanadium director and a vice president of International Mining Co. which held substantial Vanadium stock. The purpose of the introduction was to help Coen sell the 140,000 shares (Tr. 524-525). This evidence may not prove wrongdoing on the part of Korholz, but, taken with other evidence, could provide a basis for a jury to conclude that Korholz had deceived other members of the board.

Page C48:

38/

Following that investment, the value of Gypsum, relative to the value of Susquehanna, improved. If there was any causal connection between the investment and that relative change, it would suggest that Susquehanna, rather than Gypsum, was undervalued. For this purpose we assume that May should be considered the month in which Gypsum made its

investment since Korholz was acting in its behalf.

39/ Thus, if such a "fair" ratio, rather than the actual ratio, also "fair" in abstract terms, would have been the ratio chosen by arm's length bargaining of fully informed parties, then such other ratio might be relevant in the computation of damages.

40/ If Gypsum's 2,421,996 shares had been acquired on a 2 for 1 basis, Susquehanna could have issued 1,210,998 shares. At the price of $10.75 per share, the aggregate issue would have been worth $13,018,228.50. At the same price, the number actually issued on the 1.9 to 1 basis (1,274,734) was worth approximately $685,000 more.

41/ The figure of stockholder's equity used in New York Hanseatic report.

Page C50:

42/ Both Rule 10b-5 and Rule 14a-9 apply to proxy solicitations in connection with a purchase or sale of a security. See SEC v. National Securities, Inc., 393 U.S. 453, 468 S.Ct. 564, 21 L.Ed.2d 668; Swanson v. American Consumer Industries, Inc., 415 F.2d 1326, 1331 (7th Cir. 1969).

43/ Indeed, even if it should accept defendants' second version of the transaction and determine that the directors' "informed business judgment"

included knowledge that a substantial premium was being made available to the Kansas City group, the proxy statement would be misleading because that information was not disclosed to the shareholders.

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44/

"The test, we suppose, is whether, taking a properly realistic view, there is a substantial liklihood that the misstatement or omission may have led a stockholder to grant a proxy to the solicitor or to withhold one from the other side, whereas in the absence of this he would have taken a contrary course." 403 F.2d 159 at 162 (1968), cert. denied, 393 U.S. 1026, 89 S.Ct. 631, 21 L.Ed.2d 570. Since plaintiffs circulated a letter to the Susquehanna shareholders urging them to vote against the merger, we believe the comparative approach suggested by the Second Circuit as appropriate for proxy contests is also appropriate here.

45/

The "scienter" required in common law fraud is not necessary.

> "(K)nowledge of the falsity or misleading character of a statement and a bad faith intent to mislead or misrepresent are not required to prove a violation of the statute upon which a civil remedy for damages will lie." Kohler v. Kohler Co., 319 F.2d 634, 637 (7th Cir. 1963).

See also S.E.C. v. Texas Gulf Sulphur Co., 401 F.2d 833, 854-855 (2d Cir. 1968), cert denied, Coates v. Securities and Exchange Commission, 394 U.S.

976, 89 S.Ct. 1454, 22 L.Ed.2d 756, in which the court indicates that "lack of diligence, constructive fraud, or unreasonable or negligent conduct" may meet the state of mind requirement. Id. at 855. These cases discussed the required mental state in a 10b-5 case. The same requirements apply in a 14(a) proxy statement case. See Butler Aviation Intern'l, Inc. v. Comprehensive Designers, Inc., 307 F.Supp. 910, 914 (D.C. N.Y. 1969), aff'd., 425 F.2d 842 (2d Cir. 1970); Gerstle v. Gamble-Skogmo, Inc. 298 F.Supp. 66, 97 (D.C. N.Y. 1969) (even less "scienter" than required in a Rule 10b-5 case is required in a §14(a) case).

We feel it unnecessary to discuss the evidence in this case on the requisite mental state except to say that the evidence appears sufficient to warrant a jury finding that the requisite mental state existed. We note, of course, that if plaintiffs prevail on the intracorporate deception theory, then there may be some defendants who did not have the requisite state of mind.

Page C53:

46/

See the portion of footnote 5 appearing on page 383 of 396 U.S., 90 S.Ct. 616.

47/

In a letter which plaintiffs mailed to the Susquehanna stockholders urging a vote against the merger, they stated, in part:

> "We take no position here as to whether a merger between Susquehanna and American Gypsum is desirable. We do, however, take the

position that based upon the information presently available to stockholders, the terms proposed seem grossly unfair to Susquehanna. We, therefore, urge that you do not approve the merger on its present terms." (Emphasis in original). DX-68, p. 3.

48/ We identified two different kinds of legal injury in Swanson, supra:

> "Defendants next assert that no injury can be shown because any corporate opportunities or going concern value of which the Peoria shareholders might have been deprived is retained by them by virtue of their continuing equity position in ACI. The short answer is that if the allegations of the complaint are proved, the Peoria shareholders were entitled to a more favorable exchange ratio than they were granted and may have had their equity position unfairly diluted. Moreover, as recognized by the Supreme Court in SEC v. National Securities, Inc., 393 U.S. 453, 467, 89 S. Ct. 564, 21 L.Ed.2d 668, the fraudulent substitution of shareholder status in one company for the same status in another may constitute a cognizable legal injury in and of itself." 415 F.2d at 1332.

Page C59:

49/ "An insider's duty to disclose information or his duty to abstain from dealing in his company's securities arises only in 'those situations which are essentially extraordinary in nature and which

are reasonably certain to have a substantial effect on the market price of the security if (the extraordinary situation is) disclosed.' Fleischer, Securities Trading and Corporate Information Practices: The Implications of the Texas Gulf Sulphur Proceeding, 51 Va.L.Rev. 1271, 1289." SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 848 (2nd Cir. 1968), cert. denied, Coates v. Securities and Exchange Commission, 394 U.S. 976, 89 S.Ct. 1454, 22 L.Ed.2d 756.

"The essence of the Rule is that anyone who, trading for his own account in the securities of a corporation has 'access directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone' may not take 'advantage of such information knowing it is unavailable to those with whom he is dealing,' i.e., the investing public. Matter of Cady, Roberts & Co., 40 S.E.C. 904, 912 (1961)" Id. (Emphasis added).

The information which some of the directors had -- that Korholz was willing to pay $15 a share for $430,000 shares of Susquehanna stock -- was not "information intended to be available only for a corporate purpose."

APPENDIX D

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

| | | |
|---|---|---|
| MARY M. DASHO, et al., Plaintiffs, | ) | |
| v. | ) | No. 65 C 1757 |
| THE SUSQUEHANNA CORPORATION, a Delaware corporation, et al., Defendants. | ) | |

STIPULATION OF COMPROMISE AND SETTLEMENT

WHEREAS, this is a stockholders' derivative action brought on behalf of The Susquehanna Corporation, a Delaware corporation (herein called "Susquehanna") by Mary M. Dasho and Maurice H. Schy (herein collectively called the "Plaintiffs"), against Ralph A. L. Bogan, Jr., Edward O. Boshell, M. M. Hardin, J. Earle May, Aksel Nielsen, D. W. Reeves, R. C. Schenk, Harold C. Stuart and Francis C. Woolard (herein collectively called the "Settling Defendants") and against H. F. Korholz, A. D. Martin and Albert W. Thomson (herein

collectively called the "Remaining Defendants"), against other defendants heretofore dismissed; and also against Susquehanna and its predecessors in interest;

WHEREAS, Plaintiffs desire to settle all claims alleged in several complaints herein against the Settling Defendants and put at rest the action against the Settling Defendants in the manner and upon the terms and conditions hereafter set forth and deem such settlement desirable and in the best interests of Susquehanna, as is evidenced by the letter dated October 4, 1973, from Plaintiffs' counsel to Susquehanna's Board of Directors, a copy of which is attached to the signature page of this Stipulation of Compromise and Settlement (hereafter called the "Settlement Agreement");

WHEREAS, Susquehanna desires to settle all claims alleged in the several complaints herein against the Settling Defendants and to put at rest

the action against the Settling Defendants in the manner and upon the terms and conditions hereafter set forth and deems such settlement desirable and in the best interests of Susquehanna, as is evidenced by the resolution approving this Settlement Agreement passed by Susquehanna's Board of Directors on October 17, 1973, a certified copy of which is attached to the signature page of this Settlement Agreement;

WHEREAS, each of the Settling Defendants, while denying liability, desires to settle all claims alleged in the several complaints herein and to put at rest the action against each of them in the manner and upon the terms and conditions hereinafter set forth in order to avoid further expense and inconvenience and the burdens of protracted litigation and deems such settlement desirable and in his best interest; and

WHEREAS, the Plaintiffs, Susquehanna and the

Settling Defendants have no intention of releasing or otherwise impairing claims in this or any other action which Plaintiffs, Susquehanna or the Settling Defendants may have against the Remaining Defendants;

NOW THEREFORE, it is agreed by and among the parties hereto, for and in consideration of the mutual agreements contained herein, that this action shall be settled as to the Settling Defendants upon the following terms and conditions:

1. As used in the Settlement Agreement and all documentation called for herein, the following terms shall have the following meanings:

(a) "Person" includes without limiting the generality of the term, any individual, corporation, partnership or other entity, unincorporated voluntary association, party to this Settlement Agreement, or individual named as a defendant in the amended complaint.

(b) "Court" means, unless the context clearly requires a different meaning, the United States District Court for the Northern District of Illinois, Eastern Division.

(c) "Final Approval" means that the settlement encompassed by this Settlement Agreement has been submitted to the Court and the Court has approved the settlement herein and ordered the dismissal of this action on the merits as to the Settling Defendants with prejudice to Susquehanna, to Plaintiffs, to each and every shareholder of Susquehanna and to every other person determined to be proper by the Court, that all appeals or other review of the Order Approving Settlement with and Dismissing Certain Defendants (Exhibit A attached hereto) shall have been concluded without reversal or modification thereof (except to the extent provisions of said Order

which are reversed or modified on appeal are severable and are declared severable by this Court, which declaration is not reversed on appeal) or, if no appeals or other review of said Order shall have been sought, the time for taking the same shall have expired.

(d) "Closing" means the delivery of all agreements, checks and other papers provided for in this Settlement Agreement.

(e) Solely for the purposes of paragraphs 5 and 9 and for no other purpose or paragraph hereof, "default" means that Susquehanna has determined that a party has failed to comply fully with an obligation imposed upon him by paragraph 5 of this Settlement Agreement; that Susquehanna has given said party notice by registered mail of the nature of said failure; that five days then have elapsed from receipt of said notice without said alleged failure

having been cured; and that thereafter a final adjudication has been made that said party has failed to comply fully with an obligation imposed upon him by paragraph 5 of this Settlement Agreement; provided, however, the default shall be excused by death, incapacitating illness or any other occurrence beyond the control of the Settling Defendant of which excuse Susquehanna has received notice as is reasonable under the circumstances.

2. Except for paragraphs 5 and 12, this Settlement Agreement is expressly conditioned upon first obtaining Final Approval of the terms of this settlement. Otherwise, this Settlement Agreement shall be void ab initio and shall have no force and effect and all negotiations and proceedings connected herewith shall be without prejudice to the rights of any party and shall not be used for any purpose in any subsequent proceeding in this

action or in any other action or proceeding. The parties agree to cooperate among themselves and with the Court in the sending of proper notices, in recommending judicial approval of the settlement, in the presentation of appropriate evidence and in such other matters as may be reasonably required for the securing of Final Approval.

3. In consideration of the settlement of this action and of all related claims as to the Settling Defendants and the promise to deliver the indemnity agreement and covenant not to sue at the closing, the Settling Defendants agree that within five days of the entry of an order dismissing the Settling Defendants from this action with prejudice, they, through their counsel, shall deposit with the registry of the Court (1) the sum of four hundred and five thousand dollars ($405,000) which shall be invested pursuant to further order of the Court, on the motion of Susquehanna, in public or private

securities or paper as directed by Susquehanna; and in addition (2) a duly executed Release from each Settling Defendant in the form of Exhibit B attached hereto; and (3) a duly executed Assignment from each Settling Defendant in the form of Exhibit C attached hereto; and agree that said investments and documents shall be released to Susquehanna at the Closing pursuant to further order of the Court.

4. In consideration of the promise to deliver the sum of four hundred and five thousand dollars ($405,000) plus income earned thereon and other consideration, Susquehanna agrees that within five days of the entry of an order dismissing the Settling Defendants from this action with prejudice, Susquehanna, through its counsel, shall deposit with the registry of the Court as to each Settling Defendant (1) a duly executed Covenant Not to Sue or Continue Suit in the form of Exhibit D attached hereto and (2) a duly executed Indemnity Agreement

in the form of Exhibit E attached hereto; and agrees that said documents shall be released to the Settling Defendants at the Closing pursuant to further order of the Court.

5. Each of the Settling Defendants and each of their counsel agrees to cooperate with Susquehanna (but not until dismissal of this action with prejudice as to the Settling Defendant, whether or not any appeal concerning this dismissal is pending or may be filed, or after Final Approval) in this case, in Berman v. Thomson, 65 C 2051 or in any related proceedings by:

(a) in the case of a Settling Defendant, making himself available in Chicago to Plaintiffs' attorneys and to the general counsel of Susquehanna upon reasonable notice and conditions for consultation and trial preparation; provided that each Settling Defendant may at his request or upon the request of his counsel

be assisted by his counsel;

(b) in the case of counsel for a Settling Defendant, making himself available to Plaintiffs' attorneys and to the general counsel of Susquehanna upon reasonable written notice and conditions for consultation in connection with trial preparation; provided that the Settling Defendants are reimbursed promptly by the party hereto requesting said consultation for the additional reasonable legal fees and expenses charged by their counsel because of said consultation;

(c) except as provided in subparagraph (g) of this paragraph 5, speaking freely and without reservation in the course of such consultations about relevant matters of which he has knowledge or belief;

(d) except as provided in subparagraph (g) of this paragraph 5, producing for

Plaintiffs' attorneys and for the general counsel of Susquehanna for inspection and copying all relevant documents, notes, memoranda, files, pleadings and all other tangible material including any drafts thereof and including attorneys' work products; and

(e) in case of a Settling Defendant, being available upon reasonable notice and conditions to be called as a witness for Susquehanna at any trial which may be had in this case, in Berman v. Thomson, 65 C 2051 or in any related proceedings;

(f) provided, however, that any information or documents obtained pursuant to subparagraphs a, b, c, d or e of this paragraph 5 shall be used solely for purposes of this action, Berman v. Thomson, 65 C 2051, or any related case and for no other purpose; and

(g) provided further, however, that

nothing contained in subparagraphs a, b, c, d, or e of this paragraph 5 shall require or expect any counsel for the Settling Defendants (i) to breach or to permit his client to breach an attorney client obligation which he may have to any Remaining Defendant; (ii) to divulge information or to produce a document which contains the work product of any attorney presently representing a Remaining Defendant or which represents the joint work product or work effort of defense counsel involved in the first trial of this action or in preparation for the second trial of this action upon remand, or (iii) to owe any duty or obligation to Plaintiffs or Susquehanna which are incident to attorney client obligations.

Whereas any default under this provision may have grave consequences for Susquehanna, and whereas it will be impossible to estimate the actual injury

to Susquehanna which may be caused by such default, each of the Settling Defendants agrees to pay forty-five thousand dollars ($45,000) as liquidated damages in the event of his default in the course of this case, Berman v. Thomson, 65 C 2051, or any related proceeding. This liquidated damage provision supplements and does not impair the provisions found in paragraph 12.

6. The Closing will occur within ten (10) business days after Final Approval at a time and place in Chicago, Illinois that is agreeable to the parties to the Settlement Agreement, before which time the parties shall move for an order that the registry of the Court release at the Closing the investments and documents as contemplated by paragraphs 3 and 4 hereof.

7. Plaintiffs, Susquehanna and the Settling Defendants agree that if this Settlement Agreement is approved by the Court, they will jointly submit

to the Court an Order Approving Settlement With and Dismissing Certain Defendants in the form of Exhibit A attached hereto.

8. This Settlement Agreement and all documents delivered pursuant hereto shall be governed by and construed in accordance with the laws of the State of Illinois and shall be binding upon and inure to the benefit of the respective heirs, executors, administrators, successors and assigns of the parties hereto.

9. Each of the Exhibits to this Settlement Agreement is hereby incorporated by reference with the same force and effect as if set forth in full herein. This Settlement Agreement together with its Exhibits may be changed, altered or amended only by a writing executed by all of the parties hereto. Except in case of a party's breach or default, in connection with the settlement described herein and the effectuation thereof, each party will

submit to the Court only those motions, proposed orders and other documents expressly contemplated by this Settlement Agreement or submitted jointly on behalf of all parties hereto. This Settlement Agreement together with its Exhibits contains the entire understanding of the parties hereto with respect to the subject matter contained herein and supersedes all previous discussions, communications and correspondence with respect thereto. There are no restrictions, promises, warranties, covenants, undertakings or representations concerning the subject matter contained herein other than those expressly set forth herein. All representations made by any of the parties hereto under this Settlement Agreement shall be deemed to have been made both as of the date of the execution of this Settlement Agreement and, by consummation of the settlement described herein, as of the date of Closing, and shall survive the performance by the parties hereto

of their respective obligations under this Settlement Agreement.

10. The entry into this Settlement Agreement and the participation in any proceeding connected therewith shall not be deemed or construed to be an admission by any party of any liability, wrongdoing, fact, matter or defense.

11. Plaintiffs reserve the right to apply to the Court after Final Approval for an allowance of counsel fees and expenses. Susquehanna reserves the right to contest, on any ground, said application.

12. Susquehanna and the Settling Defendants will be responsible for the payment of all filing fees, costs and disbursements necessary for the implementation of the provisions of this Settlement Agreement, including the cost and expense of any reference which may be required by the court, in accordance with the following formula: Susquehanna

and the Settling Defendants will each be responsible for one-half of the foregoing up to a total of $15,000; Susquehanna will then be responsible for the foregoing up to a total of $19,000; and then Susquehanna and the Settling Defendants will each be responsible for one-half of the foregoing for the excess over $19,000; provided, however, that Susquehanna and the Settling Defendants shall bear their own legal fees and expenses except as otherwise provided in paragraph 5 hereof. However, if any fees, costs, disbursements or expenses, including reasonable attorneys' fees, are incurred by any party as a result of any breach hereunder by one or more other parties, said parties found to have committed any breach hereunder by a final adjudication shall pay all said fees, costs, disbursements and expenses. The failure to obtain Final Approval, or the breach by any Settling Defendant as to any provision of this Settlement Agreement does not

relieve any other Settling Defendant as to whom there is Final Approval of any obligation imposed by this Settlement Agreement.

13. This Agreement may be executed in one or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same agreement.

IN WITNESS WHEREOF, the parties hereto have caused this agreement to be duly executed as of this 31st day of October, 1973, in Chicago, Illinois.

PLAINTIFFS:

_____
Mary M. Dasho

_____
Maurice H. Schy

ATTORNEY FOR PLAINTIFFS:

_____
Max Wildman

NOMINAL DEFENDANT: THE SUSQUEHANNA CORPORATION

By_____

Attest_____

SETTLING DEFENDANTS:

Ralph A. L. Bogan, Jr.

Edward O. Boshell

M. M. Hardin

J. Earle May

Aksel Nielsen

D. W. Reeves

R. C. Schenk

Harold C. Stuart

Francis C. Woolard

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# CODE OF PROFESSIONAL RESPONSIBILITY

American Bar Association, December, 1974

## CANON 4

## A Lawyer Should Preserve the Confidences and Secrets of a Client

### Ethical Considerations

EC 4-1 Both the fiduciary relationship existing between lawyer and client and the proper functioning of the legal system require the preservation by the lawyer of confidences and secrets of one who has employed or sought to employ him. A client must feel free to discuss whatever he wishes with his lawyer and a lawyer must be equally free to obtain information beyond that volunteered by his client. A lawyer should be fully informed of all the facts of the matter he is handling in order

for his client to obtain the full advantage of our legal system. It is for the lawyer in the exercise of his independent professional judgment to separate the relevant and important from the irrelevant and unimportant. The observance of the ethical obligation of a lawyer to hold inviolate the confidences and secrets of his client not only facilitates the full development of facts essential to proper representation of the client but also encourages laymen to seek early legal assistance.

EC 4-2 The obligation to protect confidences and secrets obviously does not preclude a lawyer from revealing information when his client consents after full disclosure, when necessary to perform his professional employment, when permitted by a Disciplinary Rule, or when required by law. Unless the client otherwise directs, a lawyer may disclose the affairs of his client to partners or associates of his firm. It is a matter of common knowledge

that the normal operation of a law office exposes confidential professional information to non-lawyer employees of the office, particularly secretaries and those having access to the files; and this obligates a lawyer to exercise care in selecting and training his employees so that the sanctity of all confidences and secrets of his clients may be preserved. If the obligation extends to two or more clients as to the same information, a lawyer should obtain the permission of all before revealing the information. A lawyer must always be sensitive to the rights and wishes of his client and act scrupulously in the making of decisions which may involve the disclosure of information obtained in his professional relationship. Thus, in the absence of consent of his client after full disclosure, a lawyer should not associate another lawyer in the handling of a matter; nor should he, in the absence of consent, seek counsel from another lawyer

if there is a reasonable possibility that the identity of the client or his confidences or secrets would be revealed to such lawyer. Both social amenities and professional duty should cause a lawyer to shun indiscreet conversations concerning his clients.

EC 4-3 Unless the client otherwise directs, it is not improper for a lawyer to give limited information from his files to an outside agency necessary for statistical, bookkeeping, accounting, data processing, banking, printing, or other legitimate purposes, provided he exercises due care in the selection of the agency and warns the agency that the information must be kept confidential.

EC 4-4 The attorney-client privilege is more limited than the ethical obligation of a lawyer to guard the confidences and secrets of his client. This ethical precept, unlike the evidentiary privilege, exists without regard to the nature or source of information or the fact that others share the

the knowledge. A lawyer should endeavor to act in a manner which preserves the evidentiary privilege; for example, he should avoid professional discussions in the presence of persons to whom the privilege does not extend. A lawyer owes an obligation to advise the client of the attorney-client privilege and timely to assert the privilege unless it is waived by the client.

EC 4-5 A lawyer should not use information acquired in the course of the representation of a client to the disadvantage of the client and a lawyer should not use, except with the consent of his client after full disclosure, such information for his own purposes. Likewise, a lawyer should be diligent in his efforts to prevent the misuse of such information by his employees and associates. Care should be exercised by a lawyer to prevent the disclosure of the confidences and secrets of one client to another, and no employment should be

accepted that might require such disclosure.

EC 4-6 The obligation of a lawyer to preserve the confidences and secrets of his client continues after the termination of his employment. Thus a lawyer should not attempt to sell a law practice as a going business because, among other reasons, to do so would involve the disclosure of confidences and secrets. A lawyer should also provide for the protection of the confidences and secrets of his client following the termination of the practice of the lawyer, whether termination is due to death, disability, or retirement. For example, a lawyer might provide for the personal papers of the client to be returned to him and for the papers of the lawyer to be delivered to another lawyer or to be destroyed. In determining the method of disposition, the instructions and wishes of the client should be a dominant consideration.

## Disciplinary Rules

DR 4-101 Preservation of Confidences and Secrets of a Client.

(A) "Confidence" refers to information protected by the attorney-client privilege under applicable law, and "secret" refers to other information gained in the professional relationship that the client has requested be held inviolate or the disclosure of which would be embarassing or would be likely to be detrimental to the client.

(B) Except when permitted under DR 4-101(C), a lawyer shall not knowingly:

(1) Reveal a confidence or secret of his client.

(2) Use a confidence or secret of his client to the disadvantage of the client.

(3) Use a confidence or secret of his client for the advantage of himself or of a third person, unless the client consents after full disclosure.

(C) A lawyer may reveal:

(1) Confidences or secrets with the consent of the client or clients affected, but only after a full disclosure to them.

(2) Confidences or secrets when permitted under Disciplinary Rules or required by law or court order.

(3) The intention of his client to commit a crime and the information necessary to prevent the crime.

(4) Confidences or secrets necessary to establish or collect his fee or to defend himself or his employees or associates against an accusation of wrongful conduct.

(D) A lawyer shall exercise reasonable care to prevent his employees, associates, and others whose services are utilized by him from disclosing or using confidences or secrets of a client, except that a lawyer may reveal the information allowed by

DR 4-101(C) through an employee.

Footnotes omitted.

# CODE OF PROFESSIONAL RESPONSIBILITY

American Bar Association, December, 1974

## CANON 9

## A Lawyer Should Avoid Even the Appearance of Professional Impropriety

### Ethical Considerations

EC 9-1 Continuation of the American concept that we are to be governed by rules of law requires that the people have faith that justice can be obtained through our legal system. A lawyer should promote public confidence in our system and in the legal profession.

EC 9-2 Public confidence in law and lawyers may be eroded by irresponsible or improper conduct of a lawyer. On occasion, ethical conduct of a lawyer may appear to laymen to be unethical. In order to avoid misunderstandings and hence to maintain confidence, a lawyer should fully and promptly inform his client of material developments in the matters

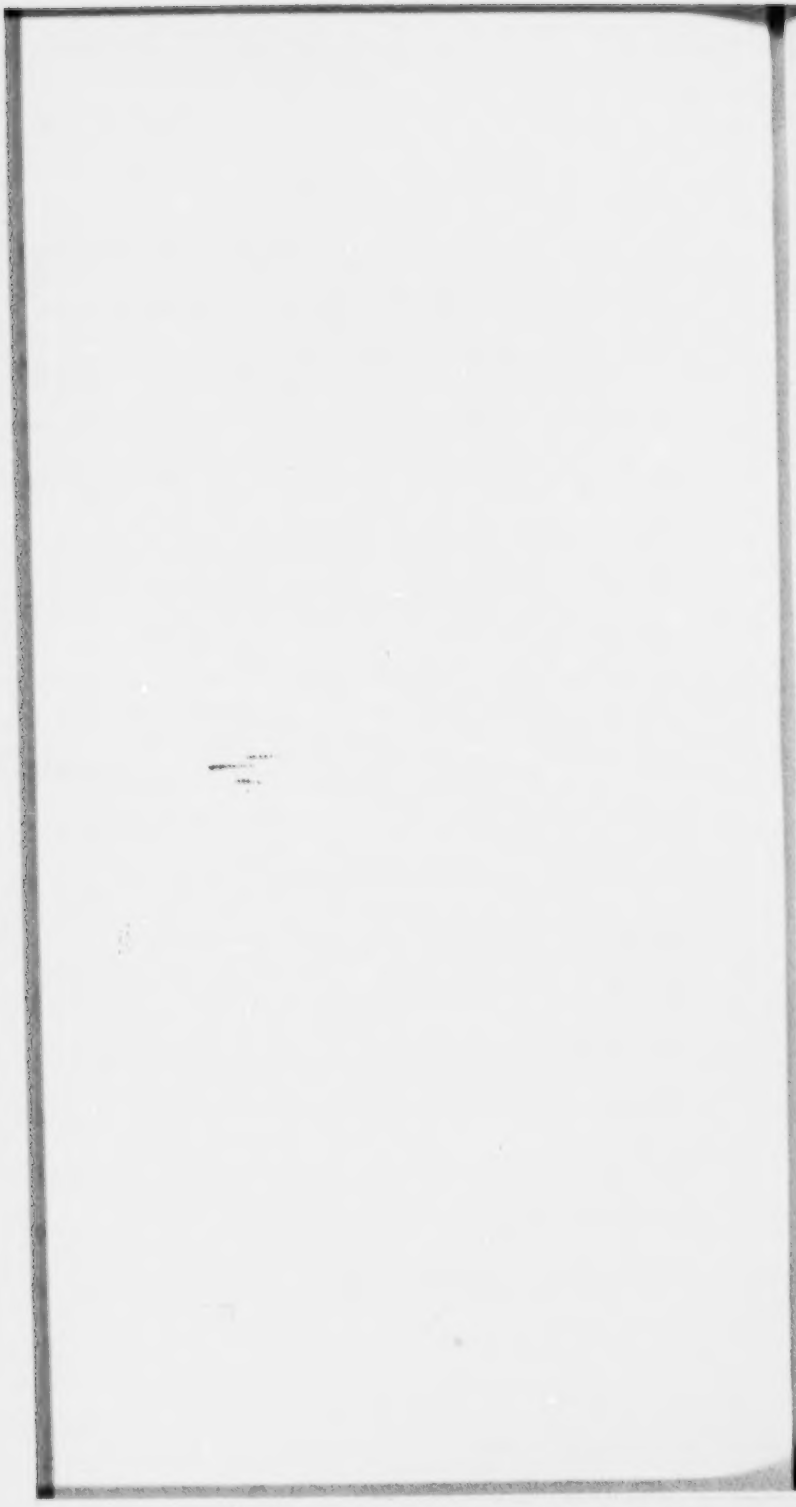
being handled for the client. While a lawyer should guard against otherwise proper conduct that has a tendency to diminish public confidence in the legal system or in the legal profession, his duty to clients or to the public should never be subordinate merely because the full discharge of his obligation may be misunderstood or may tend to subject him or the legal profession to criticism. When explicit ethical guidance does not exist, a lawyer should determine his conduct by acting in a manner that promotes public confidence in the integrity and efficiency of the legal system and the legal profession.

EC 9-3 After a lawyer leaves judicial office or other public employment, he should not accept employment in connection with any matter in which he had substantial responsibility prior to his leaving, since to accept employment would give the appearance of impropriety even if none exists.

EC 9-4 Because the very essence of the legal system is to provide procedures by which matters can be presented in an impartial manner so that they may be decided solely upon the merits, any statement or suggestion by a lawyer that he can or would attempt to circumvent those precedures is detrimental to the legal system and tends to undermine public confidence in it.

EC 9-5 Separation of the funds of a client from those of his lawyer not only serves to protect the client but also avoids even the appearance of impropriety, and therefore commingling of such funds should be avoided.

EC 9-6 Every lawyer owes a solemn duty to uphold the integrity and honor of his profession; to encourage respect for the law and for the courts and the judges thereof; to observe the Code of Professional Responsibility; to act as a member of a learned profession, one dedicated to public service; to



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cooperate with his brother lawyers in supporting the organized bar through the devoting of his time, efforts, and financial support as his professional standing and ability reasonably permit; to conduct himself so as to reflect credit on the legal profession and to inspire the confidence, respect and trust of his clients and of the public; and to strive to avoid not only professional impropriety but also the appearance of impropriety.

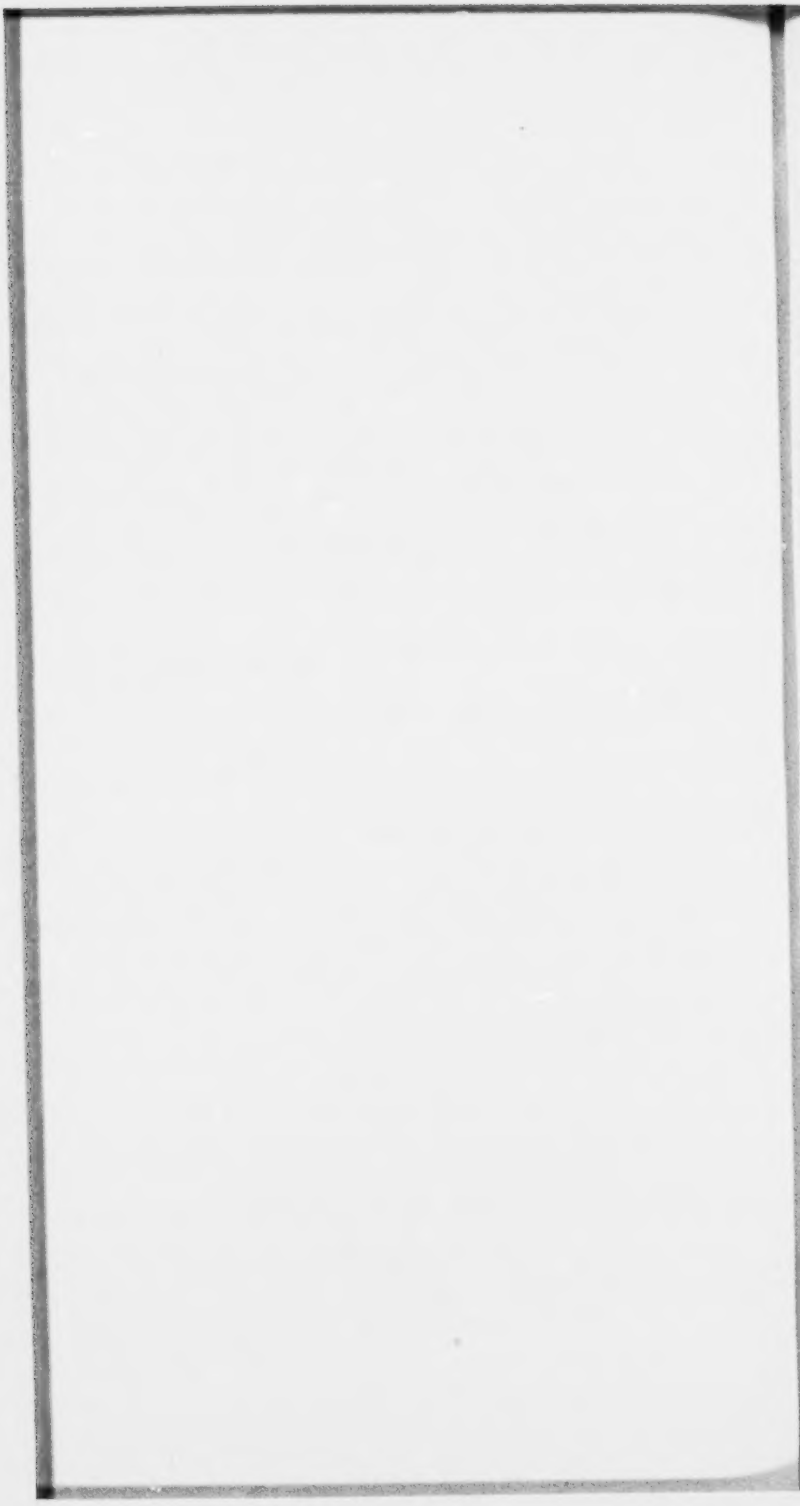
Disciplinary Rules

DR 9-101 Avoiding Even the Appearance of Impropriety.

(A) A lawyer shall not accept private employment in a matter upon the merits of which he has acted in a judicial capacity.

(B) A lawyer shall not accept private employment in a matter in which he had substantial responsibility while he was a public employee.

(C) A lawyer shall not state or imply that he



is able to influence improperly or upon irrelevant grounds any tribunal, legislative body, or public official.

DR 9-102 Preserving Identity of Funds and Property of a Client.

(A) All funds of clients paid to a lawyer or law firm, other than advances for costs and expenses, shall be deposited in one or more identifiable bank accounts maintained in the state in which the law office is situated and no funds belonging to the lawyer or law firm shall be deposited therein except as follows:

(1) Funds reasonably sufficient to pay bank charges may be deposited therein.

(2) Funds belonging in part to a client and in part presently or potentially to the lawyer or law firm must be deposited therein, but the portion belonging to the lawyer or law firm may be withdrawn when due unless the

right of the lawyer or law firm to receive it is disputed by the client, in which event the disputed portion shall not be withdrawn until the dispute is finally resolved.

(B) A lawyer shall:

(1) Promptly notify a client of the receipt of his funds, securities, or other properties.

(2) Identify and label securities and properties of a client promptly upon receipt and place them in a safe deposit box or other place of safekeeping as soon as practicable.

(3) Maintain complete records of all funds, securities, and other properties of a client coming into the possession of the lawyer and render appropriate accounts to his client regarding them.

(4) Promptly pay or deliver to the client as requested by a client the funds,

securities, or other properties in the possession of the lawyer which the client is entitled to receive.

Footnotes omitted.

FEDERAL RULES OF CIVIL PROCEDURE

Rule 23.1

DERIVATIVE ACTIONS BY SHAREHOLDERS

In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege (1) that the plaintiff was a shareholder or member at the time of the transaction of which he complains or that his share or membership thereafter devolved on him by operation of law, and (2) that the action is not a collusive one to confer jurisdiction on a court of the United States which it would not otherwise have. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority and, if necessary,

from the shareholders or members, and the reasons for his failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association. The action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs.

Added Feb. 28, 1966, eff. July 1, 1966.

# OPPOSITION BRIEF

SUPREME COURT, U. S.

FILED

SEP 12 1975

MICHAEL RODAK, JR., C

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-248

HERBERT F. KORHOLZ, *Petitioner*

v.

MARY M. DASHO, *et al.*

AND

THE SUSQUEHANNA CORPORATION, *et al.*
*Respondents*

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

## BRIEF FOR THE SUSQUEHANNA CORPORATION IN OPPOSITION

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## BRIEF FOR THE SUSQUEHANNA CORPORATION IN OPPOSITION

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### OPINIONS BELOW

The opinion of the court of appeals is reproduced at Pet. B1-B5. The opinion of the district court is reproduced at Pet. A1-A47.

### JURISDICTION

The judgment of the court of appeals was entered May 27, 1975 (Pet. B1), and the petition for a writ of certiorari was filed August 16, 1975. The juris-

diction of this Court is invoked under 28 U.S.C. § 1254 (1).

## QUESTION PRESENTED

Whether the court of appeals properly affirmed the district court's judgment dismissing this ten-year-old shareholders' derivative action against nine of the twelve individual defendants pursuant to a comprehensive, fair and equitable stipulation of compromise and settlement which allows the plaintiffs and the nominal corporate defendant, in connection with trial preparation, to obtain some informal discovery from the settling defendants and their counsel—discovery that is expressly limited by the terms of the settlement agreement and the rulings of the courts below to non-privileged matters.

## RULE INVOLVED

Rule 23.1 of the Federal Rules of Civil Procedure is set forth at Pet. G1-G2.

## STATEMENT

The petition for certiorari seeks to set aside an amicable judgment of dismissal entered in favor of nine of this action's twelve defendants, by invalidating the underlying stipulation of settlement and compromise. Petitioner is not a party to the stipulation, and the case against him still is pending in the district court. The pertinent background facts, the terms of the compromise settlement, and the rulings of the lower courts are set forth below.

1. This action, *Dasho* v. *Susquehanna Corp.*, and its companion, *Berman* v. *Thomson* (No. 65 C 2051),

were filed in the United States District Court for the Northern District of Illinois in 1965. Each is a shareholders' derivative suit on behalf of the nominal corporate defendant, The Susquehanna Corporation ("Susquehanna"), against, *inter alia,* its former officers and directors including petitioner Herbert F. Korholz, who was Susquehanna's chairman of the board and chief executive officer until 1972. Both actions charge the defendants with fraud. Summary judgment of liability has been entered against petitioner in *Berman* (Pet. A27-A28, reported at 312 F.Supp. 1031), and in *Dasho* the court of appeals has ruled that the evidence of record "would support a finding that Korholz had deceived other members of the board" (Pet. A16).

2. During the ten-year pendency of *Dasho,* certiorari has been sought and denied twice, the case has been before the Seventh Circuit three times, the district court has written six opinions, and an eight week trial has been held. Following the 1972 court of appeals decision remanding the action for a second trial, all parties attempted to reach a resolution by compromise settlement.

In 1974 the resulting stipulation of settlement and compromise among plaintiffs, Susquehanna, and nine individual defendants was approved as fair and equitable by Circuit Judge Tone (sitting by designation).[1]

[1] The factual findings and legal analysis supporting the court's exercise of its discretion are set forth in a detailed, forty-page opinion (Pet. A1-A47). In the same opinion the court declined to approve a proposed settlement proferred by the three remaining defendants, including petitioner, finding it unfair and inequitable "in view of its failure to dispose of the important subject of attorneys fees" (Pet. A8).

During the hearing "all conceivable objections to the [approved] settlement were aggressively presented by the objectors, and the interests of all shareholders, whatever the viewpoints, were adequately represented" (Pet. A41). Petitioner presented his objections in two capacities: as a party-defendant and as a Susquehanna shareholder.

3. The approved stipulation of compromise and settlement fairly and equitably disposes of all disputes between the settling defendants on the one hand, and plaintiffs and Susquehanna on the other, and petitioner does not contend otherwise. The stipulation provides for substantial monetary payments to Susquehanna, for releases and assignments of claims, for covenants not to sue and to defend and indemnify, and litigation costs are allocated among its parties (Pet. D1-D20). The stipulation also states (in paragraph five) that the settling defendants will furnish plaintiffs and Susquehanna with some informal "trial preparation" discovery (¶5(a) ) and will be trial witnesses if called in *Dasho* or in *Berman* (¶5(e) ). Related provisions apply to counsel for the settling defendants (¶¶5(b), (c), (d) ).

Privileged materials are excluded from the stipulation's discovery provisions; the lawyer-client privilege is preserved inviolate; and no duty or obligation is to be owed to plaintiffs or to Susquehanna as a result of the discovery. These ethical safeguards are spelled out in subparagraph 5(g), which reads as follows in relevant part—

> nothing contained in subparagaphs a, b, c, d, or e of this paragraph 5 shall require or expect any counsel for the Settling Defendants (*i*) to breach

or to permit his client to breach an attorney client obligation which he may have to any Remaining Defendant; (*ii*) to divulge information or to produce a document which contains the work product of any attorney presently representing a Remaining Defendant or which represents the joint work product or work effort of defense counsel involved in the first trial of this action or in preparation for the second trial of this action upon remand, or (*iii*) to owe any duty or obligation to Plaintiffs or Susquehanna which are incident to attorney client obligations.

4. The counsel involved are the Washington, D.C., firm of Rhyne & Rhyne, and the Chicago, Illinois, firm of Schiff, Hardin & Waite. They represent different groups of settling defendants at this time. At earlier stages of the litigation Rhyne & Rhyne had also represented both Susquehanna and petitioner (Pet. 11), and Schiff, Hardin & Waite had cooperated in trial preparation with Rhyne & Rhyne (Pet. 12-13). Petitioner and Susquehanna have had separate counsel in this action only since 1972.[2]

5. The district court, addressing itself to petitioner's challenge to paragraph five of the stipulation, ruled that the agreement of the settling parties could not and did not adversely affect petitioner's rights (Pet. A42). First, Judge Tone expressly found that the stipulation's discovery provisions do not ap-

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[2] Rhyne & Rhyne's representation of petitioner was coterminous with its representation of Susquehanna. That joint representation began in 1969, continued for as long as petitioner had power to select Susquehanna's counsel as well as his own, and ended in 1972 when petitioner and Susquehanna parted ways. Schiff, Hardin & Waite never represented either Susquehanna or petitioner.

ply to any matters that are privileged as to petitioner: *"Privileged communications are expressly protected by subparagraph (g) of the agreement"* (Pet. A42, emphasis added). The court therefore rejected as "without merit" petitioner's generalized claim of *per se* injury from the discovery provisions (Pet. A41), concluded that the terms of the stipulation were fair and equitable to all parties including petitioner in his capacity as a Susquehanna shareholder, and dismissed the action against the nine settling defendants. Secondly, the court deferred to further proceedings before it, during continuation of the action against the remaining defendants, any objections petitioner might have (in his capacity as party-defendant) to implementation of the stipulation's discovery provisions (see Tr. 376-380 (April 2, 1974) ).[3]

6. The court of appeals unanimously affirmed the dismissal of the action against the settling defendants, accepting the district court's construction and analysis of the compromise stipulation. The Seventh Circuit approved the finding that the stipulation's discovery provisions are not applicable to privileged matters, and it ruled that subparagraph 5(g) (Pet. B2)—

> adequately protect[s] the [petitioner] against any prejudice which may arise by reason of the per-

[3] Having concluded that rulings as to the privileged or non-privileged character of specific communications would be premature and irrelevant to the issue before him, Judge Tone heard no evidence and made no findings as to the existence or nature of any attorney-client relationships between and among petitioner, Susquehanna, Rhyne & Rhyne, and Schiff, Hardin & Waite. The court likewise heard no evidence and made no findings as to whether petitioner had transmitted any information, confidential to him alone, to those counsel, or as to whether, if he had done so in the circumstances of this action, he would have waived any attorney-client privilege.

> formance of the obligations of the settling defendants and their counsel . . . .

The court concluded therefore that the agreement was not "invalid on its face" (Pet. B2).

Turning to implementation of the discovery provisions as this action continues against the remaining defendants, the appellate court approved the deferral of specific objections and the receipt of evidence until further proceedings in the district court, which it charged with responsibility for "administration of the provisions in question" (Pet. B3). The court held, in sum, that it could not "justify invalidation of a settlement, which is otherwise invulnerable, of a major aspect of this protracted litigation," on the basis of petitioner's generalized claims of prejudice—especially since petitioner's contentions "can best be resolved by the district court pursuant to an appropriate application" for particularized relief (Pet. B2).

## ARGUMENT

The petition presents no substantial issue warranting consideration by this Court. After full and careful inquiry, the district court decided that the stipulation of compromise and settlement was fair and equitable to all litigants and to Susquehanna's shareholders (including petitioner); it therefore dismissed the action against the nine settling defendants, specifically finding that the stipulation does not permit discovery of "[p]rivileged communications" between petitioner and his counsel (Pet. A42). The court of appeals reviewed that finding and approved it. Those decisions clearly are proper exercises of judicial discretion, and petitioner cites no cases holding that a settlement agreement cannot provide for amicable discovery of non-

privileged matters. Moreover, petitioner is not and cannot be prejudiced by the courts' approval of a compromise settlement to which he is not a party, for the decisions below assure his right to seek from the district court in later proceedings any protective relief he deems appropriate.

1. The courts below properly discharged their responsibility under Rule 23.1, Fed. R. Civ. P., to scrutinize the fairness of proposed settlements in shareholders' derivative actions. Their findings are not even contested by petitioner as erroneous, let alone "clearly erroneous" (Rule 52(a), Fed. R. Civ. P.), and their judgments predicated on those findings are in full accord with settled principles governing the approval of Rule 23.1 settlements. *E.g., United Founders Life Ins. Co.* v. *Consumers Natl. Life Ins. Co.*, 447 F.2d 647, 655 (7th Cir. 1971); *Newman* v. *Stein*, 464 F.2d 689 (2nd Cir.), *cert. denied sub nom. Benson* v. *Newman*, 409 U.S. 1039 (1972); see *Protective Committee* v. *Anderson*, 390 U.S. 414, 424-425 (1968).

Petitioner's sole challenge in this Court to the judgments below is based on the assertion that, by approving the stipulation's amicable discovery provisions, the lower courts "required [Rhyne & Rhyne and Schiff, Hardin & Waite] to engage in a course of conduct which is forbidden by the ethical norms of the legal profession" (Pet. 14-15). That assertion misconstrues the decisions below and is unfounded in fact.

Both the district court and the court of appeals found that the amicable discovery provisions of the stipulation do not apply to privileged matters. And that finding of fact is unimpeachable. The stipulation specifically states that "*nothing* contained in [the discovery provisions] *shall require or expect* any counsel for the

Settling Defendants . . . to breach an attorney client obligation." Nor shall those counsel, as a result of the discovery provisions, "owe any duty or obligation to Plaintiffs or Susquehanna which are incident to attorney-client obligations." (*Supra,* pp. 4-5 (emphasis added).)

It is difficult to imagine a stronger factual underpinning for the lower courts' rulings that the compromise settlement, on its face, is valid and adequately protective of petitioner's interests (Pet. B2). Indeed, petitioner's interests not only are protected by the stipulation, they are clearly and unambiguously protected, demonstrating scrupulous deference to ethical considerations rather than the "appearance of impropriety" imagined by petitioner (see Pet. 7).[4] Thus, the words of the stipulation itself, and the courts' findings based on those words, safeguard petitioner's privileged communications while approving the right of the settling parties to share non-privileged information in preparation for trial. The judgments of the lower courts, in sum, are in every respect fair and equitable to Susquehanna's shareholders and to all the litigants including petitioner.

2. Petitioner has not been and cannot be prejudiced by dismissal of the action against the settling defendants. As the district court held in approving the underlying compromise stipulation, "[t]he parties to the agreement cannot by their agreement affect the rights of a non-party [petitioner] and they do not purport to

[4] The stipulation and the decisions below, in fact, are more protective of petitioner's interests than required by the ABA Code of Professional Responsibility. Disciplinary Rule DR4-101(C)(2) allows a lawyer to reveal confidences or secrets of his client when "required by law or court order" (Pet. E8).

do so" (Pet. A42). Amplifying that holding, the court of appeals explicitly affirmed petitioner's right to apply to the district court for any protective orders he deems appropriate (Pet. B2).

This means that during the continuation of this action against the remaining defendants, petitioner may ask the district court for relief against disclosure of matters he considers confidential; the district court has been directed to hear his claim, review the relevant evidence, and decide the issue; in due course those decisions may be reviewed by an appellate court. Adherence to that time-honored manner of judicial decision and review cannot injure petitioner. Departure from it, however, would run counter to the public interest in settling lawsuits, the judicial policy against premature decisions in a factual vacuum, and the practical interests of the settling defendants, the plaintiffs, and Susquehanna. Respondents should not be required to litigate with each other for another decade, to remain unwilling adversaries, when they choose to compromise and settle and, in so doing, have been painstakingly careful to preserve the confidentiality of any privileged disclosures by petitioner to his counsel.

3. Finally, reversal of the judgment below would in no way expedite resolution of the question of Susquehanna's right to obtain the information covered by paragraph five of the stipulation from the settling defendants, Rhyne & Rhyne, and Schiff, Hardin & Waite. Petitioner chose his counsel, he chose Susquehanna's, and he made them the same. Rhyne & Rhyne, in dealing with Schiff, Hardin & Waite, represented two clients, petitioner and Susquehanna. Whatever the relationship between those firms and petitioner, Susquehanna stands in *pari materia*. See *Simpson* v. *Motor-*

*ists Mutual Ins. Co.*, 494 F.2d 850, 855 (7th Cir.), *cert. denied*, 419 U.S. 901 (1974); *Garner* v. *Wolfinbarger*, 430 F.2d 1093, 1103 (5th Cir. 1970), *cert. denied sub nom. Garner* v. *First American Life Ins. Co.*, 401 U.S. 974 (1971).

Petitioner alleges that both firms have had discussions with him about this action after Rhyne & Rhyne ceased representing him (Pet. 11-12). Susquehanna did not attempt to prevent those communications, but it surely is entitled to equal discovery, so long as any legitimate confidences of petitioner are protected, as the courts below have assured they will be.[5] And petitioner of course has no right to prevent what the decisions below allow, the discovery of non-privileged, but perhaps important evidence by the persons whom he allegedly defrauded.[6]

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[5] Petitioner, fervid in imagining infringements of his "rights" and zealous about even the "appearance" of impropriety by others, nowhere details in the petition any steps he took to insure preservation of Susquehanna's attorney-client privilege during the period of joint representation by Rhyne & Rhyne and in the course of his post-representation communications with both firms. We assume no impropriety in Mr. Korholz' conduct or that of his counsel. Likewise, as Judge Tone observed, the courts "cannot assume that the Settling Defendants or their counsel will invade Korholz' attorney-client privilege" in implementing the discovery provisions of the stipulation of compromise and settlement (Pet. A42).

[6] Each case relied upon by petitioner (Pet. 16-26) held, in its peculiar circumstances, that an attorney could not divulge the confidences of his client. None held that an attorney could not divulge non-privileged communications. Futhermore, in each case counsel initially retained by one side later sought to participate actively on the adverse side, either as counsel or as a party. Here, by way of contrast, counsel's role in implementing the stipulation's discovery provisions is to be completely neutral, and in that role they undertake no obligations as counsel to Susquehanna (see *supra*, p. 5).

Notices of formal discovery by Susquehanna would raise issues identical to those the courts below preserved petitioner's right to raise. But it would do so in a considerably more complicated case, a case having twelve defendants instead of three, and a case where the counsel involved would still be representing nine of those defendants. The procedure outlined by the court of appeals—"an appropriate application" to the district court by petitioner after the settling defendants are dismissed—is the best vehicle for fairly resolving any issue about petitioner's rights in his allegedly privileged communications and Susquehanna's parallel rights.

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Petitioner asks this Court to protect rights the stipulation already protects, to hold what the courts below already have held—that his "[p]rivileged communications" cannot be discovered from his counsel (Pet. A42). He requests, in essence, that this Court vacate the lower courts' judgments so as to affirm the lower courts' rulings protecting the attorney-client privilege —all to the detriment of the settling defendants, the plaintiffs, Susquehanna, and the orderly administration of justice, and all to no legitimate benefit of petitioner.

Petitioner's efforts to upset the settlement of "a major aspect of this protracted litigation" (Pet. B2) should be rejected. Petitioner should be remanded to his remedies in the district court at this time, as he must be ultimately, and this action should proceed in accordance with the rulings below.

## CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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September 1975